

Evaluation of Private Enterprise Development in the ENI Region

**Submitted to USAID's
Bureau for Europe and the New Independent States (ENI)**

by

**Louis Berger International, Inc.
and
Checchi & Company Consulting, Inc.**

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The project manager and principal author was Dr. Scott Thomas, senior economist in Louis Berger's Washington office. Dr. David Holt, a consultant with Checchi & Company, served as team leader for the field efforts in Latvia and Romania, and Dr. Heidi Kroll, a consultant with Louis Berger, was team leader in Kazakhstan and Russia. The team leaders were responsible for drafting the country reports and supervising the field work in each country, including the conduct of enterprise surveys. Mr. Joyjit Deb Roy, an economist in Louis Berger's Washington office, served as survey coordinator in all four countries. Mr. Dat Bui Quang contributed to the statistical analysis. Research assistance was provided by Ms. Natalya Sokova.

The strength of the effort rested on the in-country survey teams, which were composed of the following persons. Kazakhstan: Mr. Alexandre Lapin, Ms. Elena Levchenko, Ms. Zamila Nurpelis, Mr. Aryngazi Tastandiev and Ms. Larissa Vasilkova; Latvia: Ms. Iveta Potche (Lead Surveyor) and Mr. Rolands Veinbergs; Romania: Ms. Romana Morariu, Ms. Elena Radulescu and Ms. Raluca Sidon; Russia: Mr. Valeriy Bobov (Lead Surveyor), Ms. Natalya Morozova, Mr. Victor Nosov and Mr. Alexandre Roslov.

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Executive Summary

This Evaluation of Private Enterprise Development in the Europe and New Independent States (ENI) Region is a strategic study of the sources and nature of successful enterprise development, completed for USAID. It was conducted in four economies in transition, Kazakhstan, Latvia, Romania and Russia, although the findings and recommendations may be applicable to economies in transition more generally.

The project involved macroeconomic, sectoral and institutional analysis of the sources of growth and development of private enterprise in each of the four countries, supplemented by an in-depth survey of 184 private enterprises. The survey was stratified by sector, company size, method of founding (ie., privatized or new-start), and whether the company had received direct technical or financial assistance from USAID or other donors. No state-owned enterprises or companies in monopolistic sectors were included in the survey.

Summary Findings

The following summarizes the most important findings of the evaluation:

Macroeconomic Performance

Economic stabilization, because it imposes a "hard budget constraint" on both state-owned and private enterprises, is a necessary condition for successful enterprise development.

Rapid privatization programs do not necessarily engender enterprise restructuring or improved performance, unless accompanied by a hard budget constraint and an appropriate enabling environment.

Profiles of Enterprises Most Likely to Succeed

Small and medium-scale enterprises tend to perform better than large ones. But the common definition (of up to 250 employees) is too broad to be of much use in targeting direct assistance to those enterprises most likely to succeed.

New start-up companies outperform privatized companies pretty much across-the-board. Nonetheless, as in the United States and elsewhere, failure rates of small-scale start-ups within the first five years may be quite high.

Enterprises that are founded as sole proprietorships or partnerships tend to be more successful than joint-stock companies. In part this is because of insider privatization.

Insider-controlled joint-stock companies are more likely to remain in stagnation or decline. Outsider-controlled joint-stock companies tend to fare better.

Enterprises are also likely to be more successful if they are closer to the consumer (agribusiness services rather than production, for example), and have dependable relationships with suppliers and clients. Other targeting criteria, including demonstrated product-line and employment policy flexibility, shifting from the state to a private customer base and private sources of financing, and adoption of Western business practices, tend to be strong indicators of successful enterprise performance.

High and Low-performing Sectors and Subsectors

Agricultural production continues to be constrained by an extremely hostile enabling environment. This has harmed de-collectivized agriculture, in particular, as has the preponderance of insider-controlled large former state farms and collectives.

Nonetheless, good opportunities exist in agribusiness services, such as food processing, storage, transport, distribution and retail sales companies.

Much of manufacturing remains characterized by large, inefficient behemoths that tend to produce low-quality products regardless of market demand or cost.

But there are growth opportunities, in particular for light manufacturers. New-start, medium-scale manufacturers tend to register the strongest performance in this sector.

Growth in the services sector was brisk in all four countries, led by new start-ups and enterprises privatized under small-scale privatization.¹ Larger privatized services companies tended not to perform as well.

Impact of Direct USAID Assistance

The study reviewed USAID's direct enterprise assistance strategies and programs in the four countries from various perspectives, with the goal of identifying means to achieve maximum impact.

There was strong correlation between the rankings that enterprise managers gave to the benefits that they derived from various types of direct USAID assistance and the subsequent successful performance of their enterprises according to independent and objective criteria. In particular, broad-based training in such things as Western business practices and dissemination of information about local markets was correlated with successful enterprise performance across a wide range of enterprise profiles.

¹ The evaluation specifically excluded analysis of financial services and services, such as telecommunications or electricity, dominated by state or monopolistic enterprises

In contrast, although on-site intensive technical assistance was provided more frequently to the enterprises in this sample, the correlation of this type of assistance with successful enterprise performance tended to be confined to large, privatized enterprises, especially in the manufacturing sector. Nonetheless, the assistance that USAID has provided to large, privatized manufacturers and agricultural producers is less likely to be replicated by other companies in those sectors, limiting its impact.

Instead, intensive technical assistance to enterprises should generally be targeted toward those competitive sectors and enterprise profiles most likely to succeed (see above findings). One way to leverage that assistance is to include enterprises in less competitive sectors or profiles in broad-based training and information dissemination activities. And, to improve targeting of direct enterprise assistance, enterprise surveys should be carried out periodically to assess actual impact, receive feedback from clients and improve strategic design of future activities.

Tie-ins to U.S. Trade and Investment

Although U.S. trade and investment was not the primary focus of this evaluation, at least four distinct ways in which USAID activities can help to facilitate U.S. trade and investment were identified. These included facilitating the provision of market information and logistical support to U.S. companies; facilitating intermediation between U.S. companies and local and national officialdom; promoting trade- and investment-friendly policies and institutions; and facilitating contacts between U.S. companies and local companies.

Several ways in which U.S. companies can facilitate the achievement of development objectives supported by USAID in the ENI region were also identified. These included advocating reform of the business environment; increasing competition, and thereby promoting improved quality and performance of local enterprises; and, to the extent that trade and investment follows USAID assistance, providing a "market test" of the effectiveness of that assistance.

Summary Recommendations/"Best Practices"

The study synthesizes the analytical findings and puts forward a number of recommendations (or "best practices") which practitioners may consider when designing and implementing direct enterprise assistance activities in the economies in transition. Salient among these are the following:

Coping with the Macroeconomic Environment

Much of post-privatization restructuring is blocked by the prevalence of insider-control and ineffective incentives to restructure. The best means to ensure restructuring of such enterprises is to insist on the imposition of a hard budget constraint while promoting an appropriate enabling environment and competition from new start-ups.

Lack of effective stabilization policies and an exceedingly hostile enabling environment hurt agricultural producers disproportionately. Higher priority should be given to pushing for effective implementation of economic stabilization policies and reform of the enabling environment as it affects agriculture.

Targeting Direct Enterprise Assistance

To ensure broad-based and sustainable impact, USAID should target intensive enterprise assistance toward those competitive sectors and enterprise profiles that are most likely to succeed, and rely on market forces to replicate the successes. Nonetheless, the targeting guidelines should remain flexible, because they apply on average, and not in every case.

Enterprises in less competitive sectors or profiles may be included in more broad-based training and information-dissemination programs.

Assessment of sectoral and subsectoral performance, confirmed by survey results, argues for concentrating direct assistance on light manufacturing, agribusiness services and other (nonfinancial) services, rather than heavy manufacturing or agricultural production.

Small and medium-scale enterprises tend to perform better than large-scale ones, but the definition is so broad that, as with sectoral or subsectoral targeting, additional targeting criteria should be utilized.

The strongest predictor of success relates to ownership form. This means targeting direct assistance toward new start-ups, despite the risk of small- enterprise failure. Direct assistance in the restructuring of privatized enterprises may be considered if they are not insider-controlled joint-stock companies.

Enterprises are also likely to be more successful if they are closer to the consumer (agribusiness services rather than production, for example). Missions can rely on backward/forward linkages to extend the benefits of their success to suppliers and clients.

Other targeting criteria, including product-line and employment policy flexibility, customer base and sources of financing, and adoption of Western business practices, should be factored into account.

Strategic Design of Direct Enterprise Assistance

The "wholesale" approach, by which is meant channeling direct enterprise assistance through business associations or services providers, can be a particularly useful platform. But if self-sustaining local institutions do not exist to implement this

approach, USAID activities should retain the flexibility to work directly with selected enterprises. The existence of at least some profitable "industry leaders" within a sector or region may need to precede efforts to develop successful enterprise associations or paying clientele for business services.

In those countries and regions in which access to commercial bank financing is virtually a nonexistent option, direct technical assistance and training activities should only be implemented if the enterprises have access to private enterprise financing mechanisms sponsored by donor organizations.

USAID implementors of direct enterprise assistance should be encouraged to work closely with enterprise financing mechanisms sponsored by USAID and other donors. USAID implementors' success rates in having their clients' financing projects approved by these sources, or by commercial banks, should be monitored as part of the intermediate results framework for enterprise development activities.

Monitoring the Impact of Direct Enterprise Assistance

Enterprise surveys should be integrated into USAID's ongoing monitoring of the results of direct USAID enterprise assistance. They also should be utilized to develop feedback from USAID's clients and improve the strategic design of future activities.

As part of USAID's ongoing results monitoring, the Agency's implementors should be routinely required, under the terms of their contracts and/or grant awards, to record on a periodic basis the number of enterprises assisted and the average amounts spent per enterprise, in broadly defined and common categories.

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Summary Findings and Recommendations

This Evaluation of Private Enterprise Development in the Europe and New Independent States (ENI) Region is a strategic study of the sources and nature of successful enterprise development, completed for USAID. It was conducted in four economies in transition, Kazakhstan, Latvia, Romania and Russia, although the findings and recommendations may be applicable to economies in transition more generally.

The study team analyzed macroeconomic, institutional and sectoral factors affecting private enterprise development in each country. This was complemented by stratified surveys of 184 private enterprises which gauged the importance of microeconomic characteristics and factors in determining the success or failure of individual private enterprises.² The contribution of direct USAID assistance to enterprise success was also assessed via the surveys.

The team reviewed these findings and compared them with USAID's direct enterprise assistance strategies and programs in the four countries from various perspectives, with the goal of identifying means to achieve maximum impact. Findings and recommendations are put forward as to how direct enterprise assistance efforts can be improved in future USAID programs.

A. Successful Private Sector Development

Based on a cross-country review of economic reports and analyses, a number of economic factors were determined to contribute to divergence in private enterprise performance among economies, or among sectors or subsectors within any given economy.

Economic stabilization, because it imposes a "hard budget constraint" on enterprises, is a necessary condition for successful private sector development. This means that both state-owned and privatized enterprises are weaned from explicit or implicit subsidies, and so must restructure to survive. Stabilization also means that the country's businesses can begin to benefit from lower inflation and interest rates.

Latvia's private sector, for example, benefited from that country's early stabilization by enjoying earlier and more robust resumption of economic growth. Kazakhstan's stabilization policies outperformed Russia's, in part because it succeeded in enacting a comprehensive tax code, but also because the government sector — and hence, the rate of taxation necessary to achieve fiscal stability — was smaller in Kazakhstan (19% of GDP) than in Russia (39% of GDP).

² See section IV for a detailed description of the measures of enterprise performance utilized in this evaluation.

And while Kazakhstan's economic growth indeed resumed in 1997, Russian GDP still appears to be declining.

In Romania, sustainable fiscal and monetary policies still have not been achieved, in part because favored enterprises have continued to receive implicit or explicit state subsidies. The result was a false start during the 1990s, and a return to recession last year. Discussions with the IMF currently are in abeyance.

Rapid ownership transfer programs, on the other hand, do not necessarily result in restructuring and improvement of enterprise performance, unless underpinned by a hard budget constraint and an appropriate **enabling environment** including, among other things, actionable contracts and ownership rights. Latvian state enterprises were not mass privatized, for example, although they were divested relatively quickly. But Latvian ownership rights were underpinned by rapid development of an institutional infrastructure to enforce contracts and legal claims. All but one of the Latvian enterprises surveyed were free of serious payment arrears.

By way of contrast, Russian and Kazakh state enterprises were mass-privatized, and although both economies established relatively hard budget constraints, such fundamentals as contract enforcement mechanisms and bankruptcy procedures were either rudimentary or entirely lacking. The result was a build-up of uncollectible payment arrears: About 62% of privatized Russian enterprises in the sample, and 23% of privatized Kazakh enterprises, had built-up serious payment arrears.³

Corporate governance. Form of ownership and consequent corporate governance is one of the strongest determinants of enterprise performance. Enterprises in this evaluation's survey that were founded as sole proprietorships or partnerships tended to be more successful. Insider-controlled joint-stock companies tended to have built up arrears and not to have increased product quality in comparison to domestic competitors. Outsider-controlled joint-stock companies in selected sectors (agribusiness services and manufacturing) fared better.

B. High- versus Low-Performing Sectors and Subsectors

A profile of successful private enterprise sectors in the four countries was developed based on assessment of high- and low-performing sectors and subsectors, and analysis of pooled cross-sectional survey responses, by sector, scale and method-of-founding.

Agricultural production, more than any other than other sector, continues to be constrained by an extremely hostile enabling environment. This has harmed de-collectivized agricultural production in particular, as has the preponderance of insider-controlled large former state farms and collectives, which have tended to resist restructuring. Nonetheless, good

³ Because Romanian stabilization has lagged, and especially in light of implicit and explicit transfers to favored enterprises, the relationship in that country between enterprise performance and the build-up of arrears was not deemed meaningful.

opportunities exist in agribusiness services, such as food processing, storage, distribution and retail sale.

Confirmation of these findings derives from the enterprise survey. Agribusiness enterprises tended to score poorly on proxies of enterprise profitability; and the shift from state to private customers hit agricultural producers especially hard in terms of a build-up of serious arrears. Agribusiness services, on the other hand, tended to respond to increased competition by increasing product quality if they were medium-scale, or if they were joint-stock companies controlled by outsiders.

Survey results also confirmed that agriculture tends to suffer more than any other competitive sector from failure to stabilize and provide a conducive business environment. Agribusiness managers, more than enterprise managers in the other sectors, cited inflation and interest rates as serious obstacles to their enterprises' profitability and growth. Among all agribusinesses, fully 79% of Romanian managers, 64% of Russian and Kazakh managers, and 50% of Latvian managers perceived taxes and regulations to be major impediments to their enterprises' growth and profitability.

Manufacturing. As a residual of central planning, manufacturing was characterized by large, inefficient behemoths that tended to produce low-quality products regardless of market demand or cost. This industry profile still largely holds, although there have been considerable changes in selected countries, regions and subsectors. The leader of change consistently has been imposition of a hard budget constraint, underpinned by an appropriate enabling environment, as has occurred in Latvia to a large extent, and to varying degrees in the other three countries.

Nonetheless, in every country, growth opportunities exist for manufacturing enterprises, and in particular light manufacturers, capable of taking advantage of them. The survey confirmed this analysis. Manufacturing enterprises generally tended to exhibit a build-up of serious payment arrears, and privatized manufacturers scored poorly on proxies of enterprise profitability. New-start, medium-scale manufacturers, on the other hand, tended to register stronger performance.

Services were either ignored, hindered or outlawed under Marxism, with the odd result that now the scope for growth in this sector is enormous. The evaluation team found that growth in the services sector was brisk in all four countries, led by new start-ups and enterprises privatized under small-scale privatization.⁴ Services companies surveyed during the field work tended to be free of payment arrears, and to score well on proxies of enterprise profitability. New start-up services generally tended to perform well, while privatized services generally did not, with the exception of small, privatized services.

C. Successful Private Enterprise Strategies

⁴ The evaluation specifically excluded analysis of financial services and services, such as telecommunications or electricity, dominated by state or monopolistic enterprises

The real question for microeconomic analysis is this: Where growth opportunities have existed, what were the enterprise strategies that led to success? The answer is important to managers of enterprises in the economies in transition who would like to emulate successful strategies, as well as to donor officials, who need to know what works so they can design and implement better enterprise assistance programs.

The evaluation team relied on pooled cross-sectional data derived from the enterprise survey to develop sectoral profiles of enterprise behavior associated with success. Results may be summarized as follows.⁵

Agribusiness

Agribusiness services, like food processing, storage, transport, distribution and retail sales companies, look like the best prospects in the agribusiness sector for growth and profitability. Agribusinesses that have demonstrated flexible employment policies, by shedding redundant labor and improving workforce compensation packages for retained and new-hire employees, tend to be the most successful. Large, new-start agribusinesses can be successful, and in particular, have tended to respond to increasing competition by increasing product quality. Medium-scale and new-start agribusinesses that have changed their primary source of financing from state loans to other, private sources, including retained earnings, are likely to be profitable; as are large and privatized agribusinesses that have developed external sources of financing.

Privatized agribusiness services and small agribusinesses that adopt Western business practices are likely to demonstrate improved enterprise performance. Privatized companies that institute cost tracking and budgeting systems tend to avoid serious payment arrears. New-start and medium-scale agribusinesses that establish key forward/backward linkages and strategic alliances are more successful. Ownership form is critical: Sole proprietor/partnerships, and outsider-controlled joint-stock companies are the most successful agribusiness companies.

Manufacturing

New-start and medium-scale manufacturers appear to be the best prospects in the sector for increased growth and profitability. Manufacturers that demonstrate product line flexibility in response to market demand and cost considerations are able to outperform those that are more rigid. Manufacturers facing increased competition tend to respond by increasing product quality and avoiding arrears. Manufacturers that shift their customer base from the state to private customers also tend to increase product quality and avoid arrears. Large manufacturers can be successful if they shift their primary source of financing from the state to other, private sources, including retained earnings, especially if they are able to develop external sources of financing.

Privatized manufacturers that adopt Western business practices tend to be more successful. Manufacturers that develop linkages to suppliers tend to be better performers. Ownership form is critical to the success of manufacturers: Direct control by single owners or

⁵ Only relationships that were found to hold with a 90% level of significance or higher are reported.

partners, or indirect control by an outside group of owners, is correlated with successful performance.

Services

Services enterprises generally perform better than enterprises in other sectors, especially small-scale services and new start-ups. Medium-scale services that are increasing employment tend to score well on all measures of profitability. New-start services that demonstrate product line flexibility in response to market demand and cost considerations are able to outperform those that are more rigid. Increased competition is associated with increased quality and profitability of services enterprises, especially medium-scale companies. Shifting the customer base from the state to private customers is associated with successful services.

Adoption of Western business practices was a critical element of success among services enterprises. Medium-scale services that establish business linkages and alliances tend to be successful. For services, as with the other competitive sectors, form of ownership is critical: Sole proprietor/partnerships tend to fare the best.

D. Assessment of USAID's Direct Enterprise Assistance

The scope-of-work for this evaluation required the contractor to assess the relationships between direct enterprise assistance from USAID and successful enterprise performance; and examine implications of these findings for future USAID programming priorities. The evaluation team first reviewed the design and implementation of USAID's direct assistance programs in the four countries surveyed in terms of targeting strategy, midstream adjustments made and their rationale, as well as complementarity with other USAID activities and those of other donors. This was supplemented by a series of questions in the enterprise survey about the impact of direct USAID and other donor assistance. Data analysis involved assessing whether there was significant correlation between USAID assistance and subsequent enterprise performance. This section summarizes the results of this assessment, and draws implications pertinent to future USAID programming.

Targeting Strategy

Most USAID implementors of direct assistance to enterprises in competitive sectors attempt to target enterprises that are struggling, but likely to succeed. The reasoning is that the assistance will be wasted in large part if the enterprise subsequently fails. Since the enterprises assisted are not already successful, however, USAID implementors must implement selection criteria that in some manner predict whether they are likely to succeed. Assessment of whether the enterprises assisted subsequently were successful is an exercise amenable to statistical analysis using data from this evaluation's enterprise survey. Results are summarized in the next section.

A more basic issue however, is whether, even if the enterprises that are assisted do succeed, how will those successes be replicated in the economy at large? In other words, is the

impact of the assistance broad based and sustainable? This section examines a number of targeting strategies, and their strengths and weaknesses, in an effort to illuminate these question.

Privatized Enterprises v. New Start-Ups. Although a lot of time and effort was spent early on in the transition on post-privatization restructuring of larger enterprises, Missions with more restricted budgets tended to opt for other, less costly and more targeted approaches, with good reason.⁶ Although there is often political pressure from host-country counterparts to assist large, privatized enterprises, they tend to be more rigid and less successful. In the survey carried out as part of this evaluation (see previous sections), new-start enterprises tended to outperform privatized enterprises pretty much across-the-board.

SMEs. A strategy now gaining considerable credibility among Missions is to target direct enterprise assistance to small- and medium-scale enterprises (SMEs), clearly an area in which Americans have much expertise to offer. Survey results certainly tend to confirm that this can be a more effective strategy than assisting large, privatized enterprises. But although the dynamism of the U.S. economy in terms of job creation and innovativeness derives in large part from SMEs, much of this success is based on a conducive enabling environment. This raises the question whether USAID assistance to private sector development should not focus first on improving the enabling environment, and only secondarily on providing direct assistance to enterprises. (This has been the explicit strategy followed in the Kazakhstan Mission, for example.) In addition, even in the United States, SMEs are subject to a high failure rate in the first five years of operation.

More fundamentally, the definition of SME may be too broad — up to 250 employees is the definition of SME in three of the four countries of this survey — to be of much use in "picking winners." Another concern is that the failure rate for SMEs tends to be high (reportedly very high in Russia, for example), sharpening the need for additional targeting criteria. Finally, even if the choice is made to provide support only to SMEs, there is a need for subsidiary targeting criteria to ensure that assistance provided to a relatively small number of enterprises and managers is both replicable and sustainable.

Sector or subsector targeting. Based on the findings of this evaluation, an initial shortlist of competitive sectors and subsectors in which enterprises are most likely to succeed would include food processing, storage, distribution and retail sale; light manufacturing; and (non-financial) services. But based on the survey results summarized above, a number of caveats apply.

First, targeting on sector or subsector criteria alone may be too restrictive, because there are some successful enterprise profiles outside these markets, and even within high-performing sectors and subsectors, subsidiary selection criteria should be applied. So, for example, enterprises founded as sole proprietorships or partnerships tend generally to perform well, whereas insider-controlled joint-stock companies do not. Medium-scale, new-start manufacturers are better bets than large, privatized ones. Privatized services, with the exception of small-scale

⁶ Although post-privatization restructuring projects were an important part of the Russia Mission's portfolio in the early 1990's, for example, this Mission also has re-focused its strategy toward other approaches as its budget allocations have become more restricted.

services, tend to fare poorly, as do insider-controlled agribusiness services. Finally, sector or subsector targeting in and of itself does not address the questions already raised above about achieving broad-based, sustainable impact in the economy as a whole based on providing direct assistance to a limited number of enterprises.

Retail v. wholesale providers. One means to target assistance to enterprises that addresses some of these concerns involves providing training through "wholesale" rather than "retail" providers. The concept here is to focus mainly on broader training and information dissemination, routing the assistance through industry associations or business services providers, rather than directly to enterprises. Trainers are trained, and so they can continue training once the activity ends, ensuring impact sustainability in this sense. In addition, routing the grant assistance through industry associations can be a means of strengthening them institutionally.

Broad-based training seems to make sense in sectors or subsectors where privatization and post-privatization restructuring have run their course, and the emphasis has shifted to SMEs and new start-ups. More wholesale approaches to disseminating business skills and knowledge may be desirable if the focus shifts from re-training the employees of selected enterprises to a broader strategy of promoting private entrepreneurship.

One problem with a policy to channel direct enterprise assistance exclusively through business associations or private service providers, however, is that unless there are thriving institutions of that type already in existence, the activity will have to include an effort to build such institutions as one of its ends. This presents an acute difficulty in republics of the former Soviet Union, in particular, where civil society was entirely wiped out, and in which indigenous private business associations and service providers are still rare and rudimentary. The difficulty is only compounded if the enterprises that are potential members or clients of the institutions to be created have yet to achieve profitability. A larger concern is that, although there may be additional reasons why industry associations are desirable (including development of their capacity for advocacy, discussed below), the shift in goals may relegate enterprise development activities to secondary importance.

Industry leaders. The "industry leaders" concept addresses the question broad-based sustainability head-on, while retaining the goal of improving the performance of private enterprises as the primary goal. The strategy is to target and develop successes among a core group of clients, struggling yet competitive, that will receive intensive technical assistance and training. As these clients begin to increase profitability and market share, their competitors must emulate their successful business practices in order to survive. Thus, competitive market forces are the means by which the intensive technical assistance and training is replicated among the core group's direct competitors. As these businesses grow, their backward and forward linkages will also increase business, and competition, for their suppliers and clients.

The core group of industry leaders may also be chosen in part because they are competing in strategic sectors with larger importance for economic growth and development. The assistance may be targeted, for example, toward enterprises that are attempting to compete with monopolistic state-owned or privatized enterprises that continue to dominate important points of the production and marketing chain, but are inefficient and costly. (An example would be the

technical assistance provided to encourage competition among private transporters in Kazakhstan.) A final role for industry leaders may be to advocate the policy and institutional changes that are needed to make their industries more competitive and profitable (this is discussed in the next section).

Broad-based and sustainable impact. The forgoing suggests that direct enterprise assistance is much more likely to be replicated if it is provided to enterprises in markets that are growing and profitable, because it is market competition that is the main engine driving replication of successful business practices. Without replicability, the impact of direct assistance to enterprises cannot be broad-based. Likewise, the impact of direct enterprise assistance is less likely to be sustained in markets that are not growing and profitable.

Based on the results of this survey, enterprise assistance is more likely to be replicable if it is provided to enterprises working in dynamic sectors of the economy (like agribusiness services, light manufacturing or (nonfinancial) services). In terms of sustainability, the most successful enterprises in these sectors are likely to be new start-ups, although privatized companies with clear lines of corporate control may be considered. They are also likely to be small or medium-sized companies with established and dependable relationships with suppliers and clients (or, if this is not possible, will be integrating upstream and downstream production into their own operations). And they will be able to demonstrate flexible product-line and employment policies, that their customers and sources of financing have shifted from the state, and that they have begun to implement some of the fundamentals of Western business practices.

Complementarity of Targeted Enterprise Assistance

There are a number of areas in which complementarity of USAID's direct enterprise assistance activities with others within the USAID portfolio, or with those of other donors, should be encouraged.

1. Linkages to Financing

Complementarity among direct assistance programs should be reinforced by Mission policies wherever practical. One example relates to financing. Most implementors agree that without access to financing, technical assistance and training is of much less immediate importance to enterprise managers. This raises the question whether direct technical assistance and training can be effective in countries or regions in which there simply is no realistic access to commercial financing, and where donor-funded financing options have yet to be developed.

The answer, based on interviews in Latvia in particular, where there was a significant gap between the period when the technical assistance and training was provided and the creation of an enterprise fund that could follow through, is that the impact of the assistance is blunted significantly by the lack of complementarity that can be achieved when both facets of enterprise assistance are present.⁷

⁷ It is also the case that other donor agencies (IBRD, IFC and to a lesser extent EBRD) have tended to promulgate minimum project sizes in the ENI region that have tilted their private enterprise financing programs decisively in

To the extent that USAID activity managers have fostered and encouraged collaboration between USAID implementors that provide technical assistance and training, and USAID-financed enterprise funds, as is already done in several ENI Missions, the synergies created have had a beneficial effect on the impact of both forms of assistance. It is also the case that there may be no better cross-check of the value of the grant assistance provided than the extent to which the projects that are turned over to donor financing agencies, or commercial banks, by the technical assistance and training providers, are approved for financing.

On the other hand, USAID Missions have been slower to encourage collaboration with financing agencies sponsored by other donors agencies, especially the EBRD's small business funds. Although the United States is still one of the largest contributors to the EBRD's base capital, the EU's Polish and Hungarian Assistance for the Restructuring of the Economy (PHARE) and Technical Assistance for the Commonwealth of Independent States (TACIS) programs have been much more active in collaborating with the EBRD through the provision of direct technical assistance to enterprises under consideration for financing.

2. Advocacy

This evaluation has developed a number of findings relating to the importance of a stable economy and a conducive enabling environment for successful private enterprise development. The need for economic policy and institutional reform can be a major barrier to enterprise development. Enterprise managers surveyed tended to recognize this, particularly in those countries and sectors (Romania and agriculture, respectively) in which policy and institutional reform had suffered the worst lags in terms of effective implementation. This suggests that policy and institutional reform should be given priority in such cases, but also that there is ample scope to encourage industry leaders to advocate appropriate policy and institutional reform.

One means to give momentum to policy and institutional reform is to promote advocacy groups with an interest in seeing such reforms enacted and enforced. The potential of the "wholesale approach" in respect to advocacy is that direct assistance to enterprises can be channeled through business associations, and the availability of such services may, in turn, allow those associations to build membership and go on to become successful advocates for positive change.

It is also the case, however, that failing enterprises are a poor basis on which to build effective business associations, and advocacy campaigns. This suggests that efforts to advise government officials about the need for policy and institutional reform need to be buttressed by development of successful enterprises within key sectors and subsectors whose owners and managers can advocate reform. Simultaneous provision of direct technical assistance and training to enterprises is one way to buttress such industry leaders to the point where they are capable of advocacy, either directly or through their business associations.

favor of large-scale enterprises. More recently, this trend has been partially reversed, notably with the promulgation of EBRD small business funds.

Finally, policy and institutional reform can benefit from complementarity with USAID activities that seek to promote U.S. trade and investment. As discussed in the next section, there is rarely a more persuasive advocate of the need for reform than the foreign investor, or potential foreign investor.

Correlation of USAID Assistance and Enterprise Performance

For those enterprises that had received direct assistance from USAID, a series of additional questions were included in the survey. Data analysis involved examining whether there was significant correlation between the types of assistance that were ranked by enterprise managers as very important or critical, and the enterprise's subsequent performance, as measured by independent criteria.⁸

1. Assessment of USAID Assistance Impact

The principal finding of the statistical assessment of USAID assistance impact is that there was a fairly robust positive correlation between the provision of specific types of direct USAID assistance to private enterprises and the subsequent successful performance of those enterprises. Moreover, the relationships that registered as significant were noteworthy because they were not confined to enterprises in those cross-sections, like small and medium-scale enterprises, new start-ups, or services, determined elsewhere in the evaluation to be relatively high-performing.

Instead, they also tended to occur, even to predominate, in cross-sections, like manufacturing and agricultural production, and large or privatized enterprises, which the previous analysis had predicted would be low-performing. One interpretation of these findings is that it was the USAID assistance that distinguished the high-performing enterprises from others in their low-performing profile, and in fact allowed them to become high performers. In other words, with USAID assistance, successes can be developed within sectors or enterprise profiles, like heavy manufacturing or agricultural production, that tend to be stagnant or in decline.

Nonetheless, because the evaluation's results also tend to indicate that enterprises within low-performing sectors or profiles (ie., large, privatized, insider-controlled, heavy manufacturers and agricultural producers, and so on) in general are less likely to succeed (at least without direct USAID assistance), the question remains whether the assistance provided to a select few is replicable through market competition; and if not, whether its impact can be broad-based and sustainable.

Another way of putting this finding is that, to ensure the maximum likelihood that the impact will be replicated and sustained, intensive technical assistance to enterprises should generally be targeted toward those competitive sectors and enterprise profiles with the best chance of succeeding. One way to leverage that assistance would be to include enterprises in less

⁸ The types of assistance enumerated in the survey were grouped so that they would be recognizable to the enterprise managers surveyed, and so they may not represent the full complexity of each Mission's program. Only correlation relationships significant at the 90% level or higher were analyzed.

competitive sectors or profiles in more broad-based training and information-dissemination programs.

2. Analysis by Type of Assistance Provided

As to comparative analysis by the type of assistance provided, the number of enterprises that received intensive technical assistance in this sample considerably outweighs the number that received training and information dissemination; nonetheless, assistance in the latter category was associated with successful enterprise performance across a much wider range of enterprise profiles than in the former. This is also true in the case of USAID facilitation of business deals and contacts which, although quite infrequently provided to enterprises in this sample (Latvian companies received none at all), was cited across a broad range of successful enterprise managers as key to their success.

Although fairly high proportions of the enterprises in this sample had received loans from USAID implementors, and a few had even received equity investments, the benefits of that support in terms of subsequent enterprise performance tended to be narrowly confined to manufacturing enterprises.⁹

Intensive Technical Assistance. The enterprises that performed well after receiving intensive technical assistance ranked by managers as very important or critical to their performance tended to be large, privatized or confined to the manufacturing sector. Surprisingly, marketing assistance, although one of the most frequently provided types of technical assistance, was not included among those types of technical assistance correlated with successful enterprise performance.

Instead, what worked most broadly across these enterprise profiles appeared to be project feasibility studies, which again, was one of the less-frequently provided types of intensive technical assistance. Technical assistance in production expertise was associated with high performance of manufacturers and privatized enterprises. Assistance in management, financial management and business plan development was associated with the subsequent successful performance only of manufacturing enterprises.

Training and Information Dissemination was correlated with successful enterprise performance across a much broader range of enterprise profiles, despite the fact that it was provided less frequently to the enterprises in this sample than was intensive technical assistance. Training in Western business practices tended to be ranked as very important or critical by managers of successful agricultural producers and manufacturers, and successful large and privatized enterprises. This was also the most frequently provided type of training and information provided to enterprises in this sample. A similar pattern prevailed in respect to market information, which was very important or critical to successful manufacturers and privatized enterprises.

⁹ The reasons for this are not entirely clear, because the enterprises within the sample that received financial assistance from USAID implementers were fairly evenly stratified among sectors.

Successful manufacturers and agricultural producers tended to cite directories, manuals and guides disseminated by USAID as key to their performance. Small enterprises, new start-ups and agribusiness services companies that tended to be successful also cited directories, manuals or guides from USAID as very important or critical to their success. Finally, managers of successful privatized and manufacturing enterprises, as well as small-scale enterprises, tended to rank the receipt of information about sources of finance as key to their performance.

Private Contact-Making. Again, despite the relatively small proportion of enterprises in the sample that had received USAID assistance in facilitating private business contacts and deals (none of the Latvian enterprises assisted by USAID had received this type of assistance, for example), this category was fairly broad-based in its association with successful enterprise performance. Managers of successful agricultural producers tended to rank investor contacts and site visits as very important or critical to their businesses' success. Successful medium-scale enterprise managers tended to cite assistance in making business deals, as did managers of successful manufacturing companies. Successful manufacturers also tended to cite trade show participation as important or critical to the performance of their enterprises.

Financial Assistance. Only managers of successful manufacturing enterprises tended to report that financial assistance from USAID, or USAID implementors, like the enterprise funds in each country, had been very important or critical to the subsequent performance of their enterprises.¹⁰

3. Results Indicators and Impact Measurement

Assessing the impact of foreign assistance programs is a difficult exercise, at best. Nonetheless, it is an essential check on the effectiveness of USAID activities and can be an effective tool both to receive feedback from clients and beneficiaries, and to inform the strategic design of future activities. Enterprise surveys are an important element of assessing the impact of direct enterprise assistance activities, because intermediate results indicators, like numbers of managers trained, or enterprises assisted, tend to focus on *ex ante* predictors, rather *ex post* measures, of the impact of those activities.

One question of strategic importance is whether the greater the level of direct assistance provided to any given enterprise, the greater the likelihood that it will perform well subsequently. But assessing the impact of the assistance according to the average amount spent per enterprise proved not to be possible for this evaluation, because USAID does not require regular reporting from USAID implementers, in broadly defined and common categories, about the number of enterprises assisted and the average amounts spent per enterprise.

E. Linkages between USAID Assistance and U.S. Trade and Investment

The scope-of-work required the contractor to examine implications of the findings of this evaluation for U.S. trade and investment strategies. As clarified in subsequent briefings with

¹⁰ See previous footnote.

USAID staff, this assignment was limited to the examination of two questions: (1) How can USAID help to facilitate U.S. trade and investment; and (2) How can U.S. trade and investment facilitate development objectives?

1. How Can USAID Help to Facilitate U.S. Trade and Investment?

There are at least four distinct ways in which USAID activities can help to facilitate U.S. trade and investment. These are reviewed below.

Market information and logistical support. The difficulties involved in working in the ENI region are well known. Many U.S. companies have found that without some form of continuous on-the-ground presence, doing business is not feasible; and that operations may require sustaining years of losses before getting out of the red. In short, without being able to rely on the networks that USAID helps to establish, transactions costs are extremely high, representing very real barriers to entry.

Intermediation. It is frequently the case, particularly when the activity is located in a region far from the capital city and the U.S. company cannot afford to maintain local on-the-ground presence, when intermediation by local technical experts trained by USAID can facilitate negotiation of local and national officialdom in the ENI region. This is one means by which the impacts of more broad-based USAID training activities may come into play.

Policy and institutional reform. The best run investment promotion program will not produce results if the policy and institutional environment within which it operates is not conducive to foreign investment. Much of USAID's assistance to developing countries and economies in transition is designed specifically to relieve various forms of constraints and impediments to increased trade and investment. This evaluation has underlined the importance of this work in terms of economic stability and the enabling environment for private enterprise development.

Contacts between American companies and local companies. The nuts and bolts of initiating business contacts between U.S. companies are sometimes incorporated into the design of the activity itself, or may result from contacts made by American experts from the business community when they are in the field. Although the gestation period may be long, these ultimately can develop into the most beneficial results of the assistance. As confirmed by the results of this analysis, USAID facilitation of private contact-making is correlated with broad-based enterprise success among the enterprises surveyed.

2. How Does U.S. Trade and Investment Facilitate Development Objectives?

The principal economic lesson of the modern era is that trade and investment cause increased growth, income and employment, which by any definition is economic development. Thus, increased trade and investment is an end in itself, one which many USAID activities try to promote. With that said, there are several distinct ways in which U.S. companies can facilitate the achievement of development objectives supported by USAID in the ENI region, and in so doing contribute to improving the local business climate.

Policy dialogue. As confirmed by every Mission interviewed for this evaluation, U.S. companies can represent a decisive force for positive change in the policy and institutional environment governing economic activity. There is rarely a better advocate for reform of the enabling environment than foreign companies that are either investors or potential investors.

Increasing competition. American companies can play a decisive role in increasing competition, and thereby promoting improved quality and performance of local enterprises. By wide margins, the survey results tended to show that the enterprises in the ENI region tended to increase the quality of their production in response to increased domestic and foreign competition.

"Market test" of USAID assistance. Many USAID implementors of direct enterprise assistance work actively to promote linkages with U.S. companies that will be followed by trade and investment. Although the gestation period necessary for this to occur may be extensive, there may be no better "market test" of the effectiveness of such assistance than the degree to which it subsequently brings in private U.S. companies.

F. Summary Recommendations/"Best Practices"

The forgoing analysis and synthesis of results suggests a number of potential recommendations (or "best practices") which practitioners may consider when designing and implementing direct enterprise assistance activities in the ENI Region. Salient among these are the following:

Coping with the Macroeconomic Environment

Much of post-privatization restructuring is blocked by the prevalence of insider-control and ineffective incentives to restructure. The best means to ensure restructuring of such enterprises is to insist on the imposition of a hard budget constraint while promoting an appropriate enabling environment and competition from new start-ups.

Lack of effective stabilization policies and an exceedingly hostile enabling environment hurt agricultural producers disproportionately. Higher priority should be given to pushing for effective implementation of economic stabilization policies and reform of the enabling environment as it affects agriculture.

Targeting Direct Enterprise Assistance

To ensure broad-based and sustainable impact, USAID should target intensive enterprise assistance toward those competitive sectors and enterprise profiles that have the best chance of succeeding, and rely on market forces to replicate the successes. Nonetheless, the targeting guidelines should remain flexible, because they apply on average, and not in every case.

Enterprises in less competitive sectors or profiles may be included in more broad-based training and information dissemination programs.

Assessment of sectoral and subsectoral performance, confirmed by survey results, argues for concentrating direct assistance on light manufacturing, agribusiness services and other (nonfinancial) services, rather than heavy manufacturing or agricultural production.

Small and medium-scale enterprises tend to perform better than large-scale ones, but the definition is so broad that, as with sectoral or subsectoral targeting, additional targeting criteria should be utilized.

The strongest predictor of success relates to ownership form. This means targeting direct assistance toward new start-ups, despite the risk of small- enterprise failure. Direct assistance in the restructuring of privatized enterprises may be considered if they are not insider-controlled joint-stock companies.

Enterprises are also likely to be more successful if they are closer to the consumer (agribusiness services rather than production, for example). Missions can rely on backward/forward linkages to extend the benefits of their success to suppliers and clients.

Other targeting criteria, including product-line and employment policy flexibility, customer base and sources of financing, and adoption of Western business practices, should be factored into account.

Strategic Design of Direct Enterprise Assistance

The "wholesale" approach, by which is meant channeling direct enterprise assistance through business associations or services providers, can be a particularly useful platform. But if self-sustaining local institutions do not exist to implement this approach, USAID activities should retain the flexibility to work directly with selected enterprises. The existence of at least some profitable "industry leaders" within a sector or region may need to precede efforts to develop successful enterprise associations or paying clientele for business services.

In those countries and regions in which access to commercial bank financing is virtually a nonexistent option, direct technical assistance and training activities should only be implemented if the enterprises have access to private enterprise financing mechanisms sponsored by donor organizations.

USAID implementors of direct enterprise assistance should be encouraged to work closely with enterprise financing mechanisms sponsored by USAID and other donors. USAID implementors' success rates in having their clients' financing projects

approved by these sources, or by commercial banks, should be monitored as part of the intermediate results framework for enterprise development activities.

Monitoring the Impact of Direct Enterprise Assistance

Enterprise surveys should be integrated into USAID's ongoing monitoring of the results of direct USAID enterprise assistance. They also should be utilized to develop feedback from USAID's clients and improve the strategic design of future activities.

As part of USAID's ongoing results monitoring, the Agency's implementors should be routinely required, under the terms of their contracts and/or grant awards, to record on a periodic basis the number of enterprises assisted and the average amounts spent per enterprise, in broadly defined and common categories.

I. Introduction

This Evaluation of Private Enterprise Development in the ENI Region is a strategic study of the sources and nature of successful private enterprise development completed by Louis Berger International, Inc. and Checchi & Company Consulting, Inc. for USAID. It was conducted in four economies in transition, Kazakhstan, Latvia, Romania and Russia, although the findings and recommendations may be applicable to economies in transition more generally.

The United States economy is one of the most dynamic economies in the world in terms of job creation, in large measure because of an enabling environment conducive to small business creation and growth, as well as stable prices, flexible labor and capital markets, highly developed business practices and a host of other positive attributes. Thus, it should come as no surprise that American experts have much expertise and practical advice to offer that can be extremely useful to enterprise managers in the economies in transition. Nor that the tools that are being provided by USAID to businesses in those economies can be an extremely powerful means to help them increase sales, profits and market share. But to the knowledge of this contractor, this evaluation is the first effort directly to assess the impact of direct USAID assistance to enterprises in terms of their subsequent performance. As such, it truly represents an opportunity to reflect on what has been accomplished, and how future USAID activities can be adjusted to maximize development impact.

A. Evaluation Purpose and Scope

The purpose of this evaluation is to understand the factors affecting the growth and development of private enterprise in eastern Europe and the New Independent States of the former Soviet Union during the period of transition from centrally planned to market economies. The scope-of-work requires that the evaluation, first, attempt to identify the areas and sources of economic growth in the region; second, identify and assess the relationships (if any) between such growth and USAID assistance efforts; and third, examine implications of these findings for future program priorities as well as for U.S. commercial interests. (The full scope-of-work for the evaluation is attached in Annex D.)

B. Evaluation Methodology

The study team analyzed macroeconomic, institutional and sectoral factors affecting private enterprise development in each country. This was complemented by stratified surveys of 184 private enterprises, carried out in the four countries, which were utilized to gauge the importance of microeconomic characteristics and factors in determining the success or failure of individual private enterprises. The contribution of direct USAID assistance to enterprise success was also assessed via the surveys. (Further detail concerning the evaluation methodology is contained in Annexes B, C and D.)

It should be noted that the field work for this evaluation was completed in the first half of 1998, and the first draft was submitted to USAID for review on August 15, 1998. This means

that the financial crisis that shook the Russian economy, beginning on August 17, 1998, is not reflected in the economic analysis presented here, although the lead-up to that crisis is foreshadowed in the sections of the report dealing with Russia's macroeconomic and financial accounts, and its payments crisis.

C. Evaluation Report Outline

This evaluation report, which synthesizes the evaluation team's findings and recommendations, is organized as follows. Section II identifies the economic and institutional factors underpinning or constraining successful development of private enterprise in each of the four countries, drawing findings and conclusions applicable to economies in transition more generally. Section III undertakes to define the economic environment in which private enterprises are working and competing in each country, with particular attention to both high- and low-performing sectors. This is supplemented by analytical results from the enterprise survey in each country, in which high and low performance among the sampled enterprises is assessed by primary sector, enterprise scale and method-of-founding (ie., privatized v. new start-up).

Section IV examines the question of what microeconomic factors have been associated with successful enterprise growth in the ENI region. This was accomplished by asking the 185 enterprise managers surveyed to identify various enterprise strategies and behavioral characteristics of their companies, to determine which tend to be associated with successful enterprise performance. These, derived from pooled cross-sectional analysis of the sample by stratification characteristic, are utilized to construct profiles of successful enterprises in competitive sectors.

Section V assesses the relationship direct USAID assistance to enterprises and the subsequent performance of the enterprises. Several strategies for targeting direct assistance to private enterprises are considered and evaluated. Then, survey results are utilized to assess whether there is any statistical evidence to corroborate the existence of a strong relationship between receipt of USAID assistance successful enterprise performance. Findings and recommendations are highlighted.

Section VI examines linkages between private enterprise development and U.S. trade and investment. It approaches the questions, first, of how USAID can help to facilitate U.S. trade and investment; and second, what can U.S. trade and investment contribute to the facilitation of development objectives.

Summary findings and recommendations of the evaluation are drawn together from the various different parts of the evaluation report and presented in the previous section. Four annexes provide additional detail about the evaluation's country analysis, statistical analysis, and methodology.

II. Successful Private Sector Development

The purpose of this evaluation is to understand the factors affecting the growth and development of private enterprise in Eastern Europe and the New Independent states of the former Soviet Union. This section of the report is devoted to analysis of the impact on private sector development of stabilization policies, privatization and the enabling environment in the four countries surveyed. The analysis is supplemented and confirmed by results derived from the survey of 184 enterprise managers in the four countries encompassed by this evaluation. Findings and conclusions are highlighted.

A. Economic Stabilization

1. Kazakhstan

Kazakhstan became independent in 1992 and launched a comprehensive economic reform program in January 1993. Four years later, in 1996, Kazakhstan posted its first year of official GDP growth as an independent country, and the pace of growth accelerated in 1997.

By NIS standards, Kazakhstan is an early stabilizer. After an initial attempt to bring inflation under control ended in failure in early 1994, a tightening of monetary and fiscal policy combined with a managed float exchange rate regime succeeded in reducing inflation and stabilizing the Tenge in 1994-95. Like other transition countries, Kazakhstan has experienced a decline in tax revenues as a share of GDP due in part to weak tax collection. Nevertheless, the government managed to contain its budget deficit, which remained below 4 percent of GDP from 1995 to 1997.

Following the revelation of a large stock of nonperforming loans in 1994, the National Bank of Kazakhstan developed and implemented a series of measures to stabilize the banking system, including liquidation of a large number of smaller banks and restructuring of large ones, tightening of prudential norms and standards and strengthening of bank supervision. Long-term lending to the enterprise sector remains underdeveloped.

2. Latvia

Soon after adopting a constitutional government in 1991, Latvia established a central bank and monetary board, liberalized prices, and passed legislation to open trade and foreign investment. Initially, unemployment surged, inflation skyrocketed, and GDP plummeted, by 34% in 1992 and again by 15% in 1993. Since late 1993, however, Latvia reversed all these trends, and the country has consistently improved in nearly all economic indicators. Through tight fiscal and monetary policies, inflation was brought down sharply, unemployment was systematically reduced, and GDP grew in real terms. The *Lat* was pegged to the IMF's Special Drawing Rights (SDR) and became fully convertible in 1994. Latvia has more than quadrupled foreign trade, and eliminated its budget deficit, registering a positive balance of 0.7 percent in 1997. Inflation in 1997 was about 8.4 percent, and expected to drop toward 6 percent by 1999. Unemployment has hovered between 6.5 and 7.7 percent since 1994.

By the end of 1992, Latvia had privatized all major state-owned banks, transforming nearly 80 percent of all commercial banking to the private sector. The State Savings Bank and two small specialized banks remain in state hands, but are scheduled to complete privatization in late 1998. A severe banking crisis in 1995 set the country back temporarily, but Latvia defended its currency, and quickly consolidated the banking sector under a series of new regulations on bank insolvency rules, bank supervision, and effective prudential regulations. Since then, private savings and bank deposits have increased by more than 20 percent annually, and are expected to rise by 50 percent in 1998. Commercial credits have increased to the private sector by more than 40 percent, reflecting stable and low interest rates between 12 and 18 percent, and Latvia has gained an investment grade rating by *Moody's* and *Standard & Poors* that has begun to improve FDI.

The Latvian stock exchange remains small with a two-tier (and rigorous) listing system. However, the "first-tier" stocks are cross-listed in London reported through the *Dow Jones*, and they are liquid securities. Second-tier companies are locally traded, but with active and liquid securities.

3. Romania

Romania's economic performance has been deterred throughout the 1990s by political instability, frequent redirection of fiscal and monetary policies and a multitude of economic distortions. Many of the distortions have resulted from an inability to institute sustainable fiscal and monetary policies, and in particular, continued explicit and implicit subsidies that have been extended to a select number of state-owned enterprises.

Currently the IMF program is in abeyance while discussions continue as to how to get the stabilization program back on track. The budget deficit is likely to exceed 3.6% of GDP, the official target in 1998, by a considerable margin, and the current-account deficit in the balance-of-payments could exceed 8% of GDP. Inflation soared to 157% in 1997, and the government's proposed inflation target of 47% for 1998 looks unachievable. GDP fell by 6.6% in 1997 and could fall again by 5% or more in 1998.

Fiscal policies have been marked by support for bloated and inefficient state-owned enterprises, unsustainable social obligations, and the uneven incidence of tax collection. For those enterprises that do pay, unusually high tax rates absorb scarce working capital and thwart investment. The result has been a flight to the "unofficial" sector, which now constitutes, on some estimates, 50% of national production. Tax revenues declined in 1997 and dropped further in early 1998, compounding the government's difficulties in financing social programs, regional development and various planned public investment initiatives. Planned legislation to extend financial backing to small- and medium-scale enterprises looks unrealistic.

The state-owned banking system remains in disarray. Leading commercial banks have attracted only marginal increases in savings deposits and have reduced outstanding commercial credits. There are far too many small and unregulated banks. The capital markets (BSE and RASDAQ) remain subdued, and capital values of listed companies fell in 1997 and early 1998.

4. Russia

The macroeconomic environment in Russia has not been conducive to economic recovery and growth. Russia was a relatively late stabilizer, with high inflation persisting for three years following the liberalization of prices at the beginning of 1992. A decisive tightening of monetary policy, combined with an exchange rate regime allowing the ruble to depreciate gradually against the dollar, succeeded in bringing inflation under control and stabilizing the ruble in 1995-96. However, fiscal management remained shaky due to excessive spending and weak tax collection. To finance the resulting deficits, the Russian government borrowed at high interest rates from Russian banks and foreign speculators, leading to a rapid build-up of debt and a rapid rise in debt service payments as a share of government spending.

Since late October of 1997, Russia's financial markets have been rocked by three waves of investor flight and panic. While the panics were triggered by contagion from the Asian crisis and subsequently a decline in the world price of oil (a leading Russian export), the external shocks focused investor attention on Russia's internal economic problems. Each time, interest rates have skyrocketed in an effort to defend the ruble, choking off investment and sacrificing growth. The alternative, a sharp devaluation of the ruble, could rekindle inflation by raising the price of imports, and devastate Russian banks, which have accumulated large dollar-denominated borrowings. At the end of June 1998, Russia was counting on receiving a \$10-15 billion stabilization fund from the IMF to bolster its currency reserves, shore up the ruble and provide time for a new package of austerity measures to work.

Following a crisis on the inter-bank loan market in August 1995, efforts by Russia's Central Bank to tighten prudential norms and licensing requirements and weed out unsound banks resulted in a sharp decline in the number of commercial banks. The banking system is dominated by a small number of large Moscow-based banks, most of which operate as part of financial-industrial groups. The share of long-term lending in banks' portfolios remains below 10 percent. Because they have relied so heavily on speculative profits in the currency, debt and equity markets, Russian banks have seen their profits eroded by the turmoil on Russia's financial markets. In addition, substantial dollar-denominated borrowings combined with a huge exposure to the forward dollar market make Russian banks particularly vulnerable to ruble devaluation.

B. Privatization

1. Kazakhstan

Kazakhstan has implemented a small-scale privatization program, a mass privatization program for most medium and large-sized enterprises and is in the process of privatizing very large and special enterprises on a case-by-case basis. The small-scale privatization program, which sold off thousands of small businesses and properties, is essentially completed. Mass privatization started with a voucher privatization program, but cash auctions were used to complete the process. The voucher phase was designed to concentrate ownership of privatized enterprises in a small number of government-licensed privatization investment funds (PIFs), which were supposed to exercise effective corporate governance on behalf of their shareholders,

ordinary citizens. Instead, the managers of a number of PIF managers sold off their company shares either to underwrite PIF expenses or to enrich themselves, leaving citizens with shares in PIFs that were substantially diminished or worthless in value.

With regard to its large-sized enterprises, Kazakhstan has transferred many to the control of foreign investors under management contracts. And Kazakhstan has been aggressive in granting licenses and operating concessions to Western oil companies.

The pace of post-privatization restructuring is slow, as evidenced by a massive build-up of inter-enterprise payment arrears and a continuing decline of output in most of the sector comprising large and medium industrial enterprise through 1997. The initial strategy for dealing with financially distressed enterprises favored rehabilitation over liquidation, but mainly succeeded in demonstrating the futility of trying to rehabilitate insolvent enterprises.

2. Latvia

Latvia never embraced mass privatization as implemented in other economies in transition, but the pace of ownership transfer has nonetheless been rapid. During the first two years following independence, a huge number of small enterprises, agricultural holdings, banks, and service providers were privatized through the State Property Fund. This was accomplished through denominated vouchers and direct sale listings, half of which went to managers and employees, and half to private investors. However, during 1994 and 1995, very little privatization occurred, and none of the large state-owned energy, transport, or shipping companies were listed. A second stage of privatization began in early 1996 under a new Latvian Privatization Agency (LPA), with support through U.S. assistance to restructure the remaining medium-sized firms in industry, and to commercialize the large enterprises for public sale. Many of these were privatized through tenders and limited auctions on a case-by-case basis.

The final stage began in 1997, when the remaining 60 large energy and transport companies, including port facilities and utility pipeline assets, were fully commercialized as joint stock companies and tendered to strategic investors through closed auctions. By early 1998, only 232 companies remained in the Privatization Agency portfolio. Under revised restitution laws and citizenship rules for ethnic minorities, the LPA is expected to complete its privatization mandate by mid-1999 with residential property conversions and rural land resolutions accomplished through denominated vouchers. Since early 1996, all privatization contracts have required a minimum of 51 percent cash, and any failed tenders or limited auctions have been completed through Dutch auction rules, thus ensuring a rapid completion to the privatization program.

Latvia has exempted 50 state-owned enterprises from privatization, 38 of those for security purposes and 12 as culturally protected organizations. By mid-1998, an additional 109 enterprises beyond the privatization list were determined to be insolvent, and 75 were being liquidated. The remainder were subject to reorganization under new bankruptcy laws that would allow a resolution by creditors to appoint trustees and to underwrite a private sale if deemed viable.

Changes in the Foreign Investment Law and land titling regulations in 1997 were significant factors in the latest (and final) round of privatization. Foreign investors became eligible to own both land and assets, to bid for majority stock ownership, and to freely trade on the exchange for private share capital. In addition, the risks of liability claims and disputed property rights were resolved through statutory protection against future claims. The result was that while only 13 foreign investors participated in privatization tenders between 1992 and 1996, since 1997, 153 foreign investors have tendered for major strategic investments, and FDI has become a significant factor in privatization of energy, transport, shipping, and insurance sectors.

3. Romania

Romanian privatization has been marked by a reluctance to privatize key industries quickly, comprehensively and transparently. After four years of effort, only 13 percent of the targeted firms had been privatized by the end of 1997. Although nearly 90 percent of all rural enterprises and agricultural land have been privatized, agricultural land ownership is still not transferable. The nearly 860 *regies autonomes* (state protected monopolies), 4,700 industrial enterprises, and all state-owned banks remain virtually untouched. All but 50 of these (and one bank) were specifically targeted for restructuring and privatization between 1997 and the end of 1998, yet by mid-1998, only three banks and 22 of the state monopolies had begun the restructuring process. Nearly 6,300 companies converted to joint stock companies and partially or wholly privatized prior to 1997 were listed on the RASDAQ, but less than 20 are actively traded. World Bank studies in 1995 and 1997 suggested that the State Ownership Fund sold off the least profitable enterprises with the lowest growth potential, while holding back the best firms in its portfolio.

The combination of these and other factors led the current reform government to pass broad-based legislation in late 1997, and to set up several channels for privatization. If the existing privatization program goes ahead as planned, government expects a "complete" privatization to occur by 2001. Unfortunately, this timetable looks unlikely to be achieved.

4. Russia

Russia succeeded in implementing one of the most rapid mass privatization programs on record, but it did so by giving away majority stakes in the vast majority of enterprises to managers and workers. The high concentration of insider ownership is a major impediment to restructuring, which by all indications is proceeding at a slow pace, and to the development of effective corporate governance. The slow pace of enterprise restructuring is evidenced by an explosion in all kinds of enterprise arrears (on taxes, wages and payments to suppliers for inputs, fuel and electricity), a proliferation of IOUs and various other money surrogates, and an escalation of the share of barter in industrial sales following the tightening of monetary policy in 1995.

C. Enabling Environment

1. Kazakhstan

The enabling environment for private enterprise in Kazakhstan features the early adoption of a modern tax code that is frequently held up as a model of clarity, simplicity and transparency, with generally low tax rates and a broad tax base. Nevertheless, high and unpredictable taxes emerged as one of the most important constraints on the development of small and medium enterprises (SMEs) in an EBRD survey of 850 SMEs. Extensive and onerous registration and licensing requirements have impeded the establishment of new private firms in the past, and licensing requirements continue to impede the participation of businesses in a wide range of activities. Unreasonable harassment by public officials and outright corruption were cited as the first or second most important constraints on the operation of SMEs in the aforementioned survey.

According to EBRD sources, per capita FDI in Kazakhstan increased from an average of \$45 in 1994-95 to \$67 in 1996. Leading U.S. exports to Kazakhstan include telecommunications equipment, equipment for the oil and gas sector, machinery and tobacco products. Major investments by U.S. companies in Kazakhstan have been concentrated in the energy sector (including oil and gas, coal and electric power) and tobacco processing. Both food exports and investment in food production and catering have been negligible.

2. Latvia

During the early transition years, Latvia suffered lost government revenue because of high tax rates and poor collection. Since early 1996, sweeping tax reforms have created a 25 percent flat tax rate (with a further 20 percent reduction for qualified small enterprises). New laws also have begun a phased reform of social insurance and pensions, while instituting land and enterprise registration systems. The result has been a sustained 20 percent annual increase in tax collections, and by some estimates, a 50 percent reduction in the unofficial economy, as businesses register and employees are motivated to report income and taxes, thus protecting their social benefits. Private sector employment has grown consistently, and is now more than 72 percent of total employment, accounting for approximately 60 percent of GDP. By the year 2000, private employment is expected to reach 80 percent and contribute more than 70 percent to GDP.

Latvia has enacted commercial legislation to ensure sensible bankruptcy proceedings and corporate reorganization, simplified its forms of ownership and enterprise registrations, and created a basis for collateralizing assets. A revised commercial code is expected to be passed during the current parliamentary session together with initiatives to support SME development. The country has introduced bank deposit insurance and credit guarantees, thus enhancing protection for all forms of savings and commercial loans. New judicial proceedings coupled with substantial training for judges and local magistrates have boosted confidence in a rule-by-law environment, and statutes protect foreign investors. Capital markets are transparent, and pervasive laws exist to protect minority shareholders and to protect against insider trading. A missing link is the lack of effective venture capital, yet new legislation recently passed provides

for institutional investments, and a legal framework for a mortgage market that has begun to appear through joint U.S.-Latvian enterprise funds.

The country effectively removed all major barriers to foreign trade and investment by 1993 with a stable and convertible currency, full repatriation rights to invested capital and profits, reduced customs tariffs and a transparent system of domestic and international transactions. Cumulative total FDI by the end of 1997 seems low at \$978 million, yet this represented a per capital FDI of \$391, rivaling the leading central and eastern European economies. By the end of 1995, Latvia had 1,245 international joint ventures with 17 foreign source nations. This number rose to 2,031 joint ventures and 43 countries by the end of 1997. In absolute terms, these numbers are small, yet FDI is expected to continue to grow at more than 30 percent annually through the year 2000. Latvia has MFN status with the United States and open trade agreements with 24 other nations. It was also a joint founder of the Baltic Trade Alliance, and signed the EU Association Agreement, subsequently coming fully into compliance for EU membership.

3. Romania

The Romanian economy is characterized by large transactions costs resulting from complex and opaque legal, regulatory and institutional requirements. As a result, Romanian enterprises face uncertain markets, crippling resource constraints, scarce capital, and official corruption. Together, these are strong incentives to divert production into unofficial channels or to hide employment and income from official ledgers.

High tax rates and uneven or corrupt tax collection continue to plague private enterprises generally, and to discourage SMEs in particular, while encouraging flight to the "unofficial" sector. Laws, regulations and policies governing commercial activities remain piecemeal and incoherent, and their inconsistent enforcement creates enormous incentives for corruption and graft. Statutory laws on collateral, judicial bankruptcy, property rights, titles, credit claims, and investors' rights frequently are in dispute or unenforceable. There are insufficient judges or magistrates, inadequate judicial training, and little confidence in the judicial system. And foreign trade is hampered by frequent changes in customs policies and ineffective enforcement.

Political instability, confusing legislation, absence of rule-of-law, endemic corruption and the apparent inability to take on the state-owned banks and the giant *regies autonomes*, or state monopolies, combine to thwart a turnaround in FDI. As a result, Romania is one of the lowest per capita recipients of foreign direct investment in central and eastern Europe, and FDI per capita is falling. In 1995, net FDI per capital was barely \$17, which fell to \$12 in 1996, and rebounded to only \$15 in 1997. Among the foreign investing nations, the United States ranked fifth with a cumulative \$219 million invested in 2,347 companies, according to the Foreign Trade Registry Office. However, the U.S. Commercial Office placed U.S. FDI at an accumulated \$1.71 billion by April 1998.

4. Russia

Russia's enabling environment has not been conducive to enterprise growth and development in a number of respects. The tax system is a major barrier to growth and investment

due to the excessive burden full compliance imposes on enterprises, the complexity and lack of clarity created by a proliferation of taxes and exemptions, and the arbitrary and uneven application of the tax law by tax inspectors. These characteristics have encouraged widespread tax evasion. Former state enterprises do not yet face a credible bankruptcy threat, while registration procedures and other requirements impede the establishment of new firms. The operation of small and medium businesses is hampered by frequent bureaucratic interference, ranging from inspections to outright extortion.

According to EBRD sources, per capital FDI in Russia increased from an average of \$9 for 1994-95 to \$14 for 1996. There was a sharp increase of FDI from 1994 to 1995. The leading U.S. exports to Russia are meat and food products, tobacco and machinery. U.S. investment in Russia is heavily concentrated in the agribusiness sector, including catering and production of food, beverages and cigarettes. Impediments to foreign investment in the energy, most notably with regard to legislation on production-sharing agreements, have limited commitments by U.S. oil companies to a fraction of their potential levels

D. Findings and Conclusions

Economic stabilization. Macroeconomic stabilization is a necessary condition for successful development of private enterprise because it imposes a "hard budget constraint" on enterprises. This means that both state-owned and privatized enterprises are weaned from explicit or implicit subsidies, and so must restructure to survive. Economic stabilization also means that the country's businesses can begin to benefit from lower inflation and interest rates.

Latvian enterprises, in particular, benefited from that country's early stabilization by enjoying earlier and more robust resumption of economic growth. Kazakhstan's stabilization policies outperformed Russia's, in part because it enacted a comprehensive tax code, but also because the government sector — and hence, the rate of taxation necessary to achieve fiscal stability — was smaller than Russia's. In Romania, by way of contrast, sustainable fiscal and monetary policies has not been achieved, in part because favored enterprises have continued to receive implicit or explicit state subsidies.

Comparative analysis from the four countries surveyed confirms this analysis. As part of the survey, enterprise managers were asked to rank the impact on their enterprises' profitability of factors in the economy beyond their control. The results tended to confirm that there were striking differentials among countries in the degree to which the business environment adversely affected enterprise performance. A majority of Romanian enterprise managers (54.3%) reported that inflation very adversely affected their companies' performance. The second worst performer on inflation, as ranked by the enterprise managers surveyed, was Russia (22.4%), followed by Kazakhstan (18.2%) and Latvia (8.7%). Similarly, interest rates were very adversely affecting enterprise performance according to 61.1% of Romanian enterprise managers, 60.0% of Russian managers, and 27.2% and 17.4% of Kazakh and Latvian enterprise managers, respectively.

Privatization and the enabling environment. On the other hand, rapid ownership transfer programs are not necessarily associated with the restructuring and improvement of

enterprise performance, unless underpinned by an appropriate enabling environment including, among other things, actionable contracts and ownership rights. Latvian state enterprises were privatized relatively quickly, and ownership rights were underpinned by rapid development of an institutional infrastructure to enforce contracts and legal claims. All but one of the Latvian enterprises surveyed were free of serious payment arrears.

In contrast, Russian and Kazakh state enterprises were mass-privatized, but such fundamentals as contract enforcement mechanisms and bankruptcy procedures were either rudimentary or entirely lacking. The result was a build-up of arrears in tax, loan and wage payments, and payments to suppliers, against which there was no serious legal recourse. About 61% of privatized Russian enterprises surveyed, and 23% of privatized Kazakh enterprises, had built up serious payment arrears.¹¹

Corporate governance. The other striking aspect of rapid ownership transfer programs has to do with the form of ownership that resulted from them, and in particular, whether enterprise control was simply transferred to enterprise insiders — management and workers — despite the concern that their interests could conflict with the enterprise's bottom line. Based on pooling survey responses from all four countries, this seems to be a significant problem for post-privatization enterprise performance. Enterprises founded as sole proprietor or partnerships tended to be free of enterprise arrears, and to have responded to increased domestic competition by increasing product quality in comparison to domestic competitors. In contrast, insider-controlled joint-stock companies tended to have built up arrears and not to have increased product quality.¹² In Russia and Kazakhstan, the leading defaulters among enterprises surveyed were insider-controlled joint-stock companies (60% of such enterprises in Russia and 32% in Kazakhstan). One tentative conclusion from this result is that donor hopes that markets for corporate control would arise post-privatization to rectify the ill effects of insider privatization have not yet been realized in terms of enterprise performance.

Accordingly, the best means to ensure that insider-controlled companies are restructured (or liquidated) is to insist on the imposition of a hard budget constraint, while promoting competition from new start-ups.

¹¹ Because Romanian stabilization had lagged, and especially in light of implicit and explicit transfers to favored enterprises, the relationship in that country between enterprise performance and the build-up of arrears was not meaningful.

¹² There was no significant relationship one way or the other in the pooled sample between outsider-controlled joint-stock companies as a form of ownership and the existence or absence of arrears, although this relationship did appear to be significant in selected cross-sections of the sample (see section IV).

III. High-versus Low-Performing Sectors and Subsectors

The scope-of-work for this evaluation states that the contractor should, first, assess where "accelerated growth and development of private enterprises" seems to be taking place in the ENI region; and second, identify important explanatory or contributing factors to such growth. Section II of this report has been devoted to presentation of the constraints to private sector development posed by stabilization policies and the enabling environment in the four countries surveyed.

This section presents more detailed review of the economic environment in which enterprises are working and competing, with particular attention to identifying high- and low-performing sectors and subsectors. It presents the rationale for the sectoral divisions that were selected for review and analysis by the evaluation, and for their utilization as stratification characteristics in the enterprise survey in each country. Then country-specific statistics concerning the number, scale, ownership structure and privatization experiences of enterprises in each sector are presented.

This is followed by review of survey results, country-by-country, concerning enterprise performance by stratification characteristic. Survey responses also are drawn upon to highlight what managers in each country perceive to be the strengths and weaknesses of their enterprises, with results presented by sector, scale, method-of-founding and form of ownership.

Findings and conclusions are integrated into a cross-country profile of high- and low-performing private enterprise sectors in the four countries surveyed, based on the foregoing assessment and confirmation of this analysis that is derived from pooled cross-sectional survey responses, by sector, scale and method-of-founding.

A. Stratification Approach and Rationale

The stratification approach utilized in this evaluation was to analyze enterprises in three broad sectors, first in sectoral overviews, and subsequently through direct enterprise surveys. Those three sectors were agribusiness, manufacturing and services. These sectors broadly parallel the sectoral division of economic activity by the World Bank for all member countries, into agriculture, manufacturing and services, as reported annually in the World Development Report. The intention was to define a small number of broadly distinguishable sectors, so that the sample would not be fissured into too many cross-sections to be amenable to statistical analysis.

Although there is some discussion within the analysis of the economic environment in each country of all sectors, including financial, telecommunications, energy and services sectors, the survey analysis was confined to enterprises in competitive markets, effectively ruling out enterprises with natural or state-mandated monopoly positions. This precluded detailed assessment of most infrastructure services and the energy sector. The reason for this is simple: Enterprises in non-competitive sectors are likely to respond much differently to economic and market signals than those in active competition, and these structural differences would prevent valid comparative statistical analysis of the factors affecting enterprise performance. For similar

reasons, it was decided not to conduct surveys of financial services enterprises, because of the particularity of this sector and of the manner of its regulation.

The stratification approach had to be modified once the survey work was completed because the agribusiness sector proved to be too aggregated a concept to yield robust statistical results. The reason is that agribusiness, as initially defined, included both agricultural production and agribusiness services (ie., food processing, storage, transport, distribution and retail sales), and the characteristics of these two types of enterprise were sufficiently dissimilar to require their separation for purposes of analysis. Accordingly, the raw statistical forms were reviewed and agricultural producers separated from agribusiness services, based on consideration of their primary product lines, for purposes of further statistical analysis.

B. Sectoral Overviews

1. Kazakhstan

As of December 1, 1997, there were 146,213 enterprises in Kazakhstan, more than 80 percent of which were in the private and other nonstate (mixed and foreign) sectors. Trade and catering accounted for the largest share (21 percent) of the total number of enterprises, followed by industry (14 percent) and agriculture (almost 8 percent). Small and medium enterprises (those with less than 250 employees) accounted for more than 96 percent of these enterprises, but less than 10 percent of total employment in Kazakhstan.

Table 1
SECTORAL COMPOSITION OF GDP IN 1996 AND 1997

Sector	Share of GDP (%)	
	1996	1997
Agriculture	12.2	11.0
Manufacturing	25.6	24.9
Services	57.0	59.0
Indirect Taxes	5.2	5.1

Source: (IMF, 1997, *Kazakhstan Economic Trends*, 1998, and *Natsstatagenstvo*, 1998)

Table 2
ENTERPRISE SIZE (DECEMBER 1, 1997)

Size	Share (%)
Small enterprises	87.0
Medium enterprises	9.6
Large enterprises	3.4

Source: Committee for Statistics and Analysis (CSA, formerly NSA); KET calculations

Kazakhstan posted its first year of official GDP growth in 1996, and the pace of growth accelerated in 1997. Kazakhstan's recovery is due to a combination of consumption-led growth and export-driven growth. Trade and catering boomed in 1996 and continued to grow strongly in 1997. Food and light industry also grew strongly in 1996 and 1997, though virtually all of this growth took place in "household production," with production by enterprises continuing to decline. Growth is also taking place in Kazakhstan's leading export industries, including fuels and ferrous and nonferrous metallurgy, which have also received the lion's share of foreign direct investment. Virtually all other industrial sectors continued to decline in 1996 and 1997. Within agriculture, the recovery has been led by grain production, with production of livestock products continuing to decline.

2. Latvia

As of January 1998, there were 129,687 registered companies in Latvia, of which, 127,919 were domestic private commercial enterprises. The private sector accounted for 72.8 percent of registered employment. The remaining 1,768 registrations were state-owned, non-governmental organizations, or representative offices of foreign companies. Of those, only 323 companies were fully state-owned, and as noted elsewhere, a majority scheduled for privatization. These data do not include 94,905 peasant farms and 81,902 individual orchards that are recorded under a separate agriculture and land registry.

Table 3
SECTORAL COMPOSITION OF GDP IN 1996 AND 1997

Sector	Share of GDP (%)	
	1996	1997
Agriculture	9.2	9.8
Manufacturing	32.0	32.5
Services	58.8	57.7

Source: Latvia Ministry of Finance, *Economic Performance*, 1998, and *IMF Staff Country Report*, 96/143 (1996). Manufacturing includes industry, electricity, gas & water, and construction.

At the end of 1997, agriculture represented 9.8 percent of GDP, industry contributed 18.6 to GDP, energy resources added 5.9 percent, construction provided 8.0 percent, and all services constituted 57.7 percent of GDP. In the Latvian context, "industry" includes agricultural production, food processing, milled products, bakeries, fish products, and meat packing. The subsector of *food processing* constitutes the largest portion of the country's manufacturing output (24.6%). If grain milling, dairy, fish, meat, and bakery (41% of the subsector) were included in agriculture, the contribution of agriculture to GDP would rise to approximately 17.5 percent and represent a slight growth trend (up from a range of 15-17 percent, 1990-1996). As it stands, agriculture excluding all food processing declined sharply from approximately 15 percent (1990-1993) to the present 9.8 percent share of GDP.

There are several high-growth subsectors where Latvia is expected to make its mark during the next few years. It has a distinct advantage through technology and engineering skills for carriage, rail, and urban transit products slated for export. It has a solid core of chemical research and production positioned in medical additives and intermediates which it exports to Russia, the EU, Sweden, and the United States. The country has developed a strong information technology and telecommunications "branch" sub-sector in related components, network research, and systems platforms. Domestic demand is strong and growing, but foreign demand in conjunction with foreign-invested interests or contracting has been even stronger, exceeding productive capacity.

Although agriculture continues to lag and is troubled by lack of effective rural development and farm credits, food processing has grown rapidly with prospects for expanded trade with the EU, Baltics, and Scandanavia. Latvia's forests are rich, and the wood industry has demonstrated a high demand for its production of construction products, plywood, quality finishing woods, and hardwoods. Early and rapid privatization of retail and wholesale trade, hotels and catering, and financial intermediation has resulted in these high-growth results. Slower growth is expected as most of these services subsectors stabilize.

Table 4
ENTERPRISE SIZE (DECEMBER 31, 1997)

Size	Share (%)
Small enterprises	83.3
Medium enterprises	12.1
Large enterprises	5.6

Source: Latvian Development Agency, *Economic Survey Latvia*, March 1998.

Table 5
PRIVATE ENTERPRISE ORIGIN (DECEMBER 31, 1997)

Sector	Start-up (%)	Privatized (%)
Agriculture	15.8	84.2
Manufacturing	35.5	64.5
Services (private)	78.8	21.2

Source: Latvian Development Agency, *Economic Survey Latvia*, March 1998

Latvia is a nation of relatively smaller enterprises. Privatization and liquidation has broken up a majority of industrial complexes with the exception of energy related companies and state transport and shipping facilities. Consequently, 95.7 percent of all registered companies (including agricultural and peasant farm registrations) are small or medium-sized enterprises (less than 250 employees). Exempting agricultural and peasant farm listings, 67.4 percent are SMEs, but in reality, only 4.1 percent of all commercial enterprises, regardless of ownership, are large, with barely 2.1 percent exceeding 1,000 employees. The SMEs (including agriculture) employ 70.6 percent of all workers.

3. Romania

Romania does not have an effective system of enterprise registration, and historically, the Chamber of Commerce and Industry has had the responsibility to license enterprises and maintain provincial registry lists. Consequently, enterprise registration is not well enforced, and data is updated through periodic reports collected from regional offices. With that said, the latest official list from the National Chamber office is October 1997, showing a total of 661,657 businesses of which 281,204 were state-owned, and 88,010 had mixed private and public shareholders; approximately 290,000 were privately owned. Of these, nearly 55,000 were agricultural. Based on government estimates of the unofficial economy (considered low at 31%), many more enterprises may be operating than are officially registered.

Table 6
SECTORAL COMPOSITION OF GDP IN 1996 AND 1997

Sector	Share of GDP (%)	
	1996	1997
Agriculture	19.1	19.8
Manufacturing	42.6	41.4
Services	38.3	38.8

Source: Romanian National Statistics Commission, *Quarterly Bulletin of Statistics*, Nr. 4 (1997), and *IMF Staff Country Report*, 97/46 (1997).
Manufacturing includes industry & extraction, and Construction.
Services include trade and other services.

Table 7
ENTERPRISE SIZE (DECEMBER 31, 1997)

Size	Share (%)
Small enterprises	83.1
Medium enterprises	11.5
Large enterprises	5.4

Source: Romanian National Statistics Commission,
Quarterly Bulletin of Statistics, Nr. 4 (1997).

The Romanian agriculture and forestry sector has declined since 1990 in spite of broad-based land restitution and increased demand for food products, processed meats, and retail groceries. The potential for agricultural development is nonetheless vast, perhaps five-fold from current levels, with adequate production and processing incentives, and improved storage, distribution and trade opportunities. However, growth is thwarted by severely limited state-owned cold storage, grain silage, dock handling, and wharf facilities. State-controlled prices at these facilities are high, and their efficiency is low by international standards. Compounding problems, entry into these agribusiness services by private companies is restricted, and grain and meat processors are subject to standards and licensing controls that amount to high barriers to entry.

Manufacturing and the extraction sectors (mining and quarrying) are likely to shrink further in the near term. Romania has immediate cost advantages in wages and materials, but a bloated industry with inefficient state-owned enterprises and backward technologies will plague industrial development. Privatization can infuse manufacturing with modern business practices and new markets, as well as bring in needed capital, but in the near term, investments are expected to remain slim and industrial recovery slow.

Trade and services have not "officially" expanded, yet the evidence suggests that both wholesale and retail services have grown vigorously. Unfortunately, the growth seems to have remained in the gray markets and among unregistered enterprises. Construction trades have grown rapidly as a percent of GDP, but the entire sector is small and disorganized. Nonetheless, pent-up demand may emerge in rapid housing and reconstruction. Transport services have reportedly declined in every segment, every year. Little investment has gone into roads, railbeds and rolling stock, docking facilities, river barge systems or port handling. These shortcomings have strangled growth in other sectors. The post and communications sub-sector, largely state-owned but scheduled for privatization, may shift dramatically toward private ownership and become a primary area for foreign investment. During 1997, it was the fastest growing economic area of activities with a 25 percent growth in investment and a 42 percent increase in component manufacturing. Finally, the hospitality industry has grown rapidly, but as a small segment of the total services area, this sub-sector coupled with tourism and all business travel does not have a significant effect on GDP.

4. Russia

At the beginning of 1997, there were 2,487,000 Russian enterprises, the vast majority of which (78 percent) were in the private and other nonstate (mixed and foreign ownership) sectors. Since the start of mass privatization in 1992, approximately 127,000 enterprises have changed their ownership form. Trade and catering account for the largest share (almost 30 percent) of enterprises, followed by agriculture (almost 14 percent) and industry (13 percent). The official small business sector accounted for almost 39 percent of the total number of Russian enterprises at the beginning of 1996, and since 1995 has employed about 13 percent of the Russian labor force.

Table 8
SECTORAL COMPOSITION OF GDP IN 1996 AND 1997

Sector	Share of GDP (%)	
	1996	1997
Agriculture	15.3	14.0
Manufacturing	25.7	24.4
Services	58.9	61.6

Source: Goskomstat Russia, *Russia in Figures 1997: Short Statistical Compendium*. Moscow, 1997.

The salient feature of Russia's economic performance since the launching of comprehensive market reforms at the beginning of 1992 is the prolonged duration and sheer depth

of the contraction in output that has accompanied the transition process. According to official statistics, 1997 was the first year of growth in GDP since output started to fall in the late 1980s.

The recovery in 1997 reflected a combination of consumption-led growth and export-driven growth. In the services sector, retail sales, wholesale trade and paid services (mostly personal and public services) all grew in 1997. Within industry, consumer goods production had the highest growth rate in 1997. Growth also occurred in Russia's leading export industries, including oil, ferrous and non-ferrous metallurgy, chemicals and timber and paper products. Industries that make investment goods and construction materials continued to decline. Agricultural production stabilized in 1997 as a result of a good harvest, with production of animal products continuing to decline.

C. Survey Analysis by Country

1. Kazakhstan

Of a total of 44 enterprises surveyed in Kazakhstan, 41 percent were in services and the balance was evenly divided between manufacturing and agribusiness (29.5 percent each). With regard to size, 34 percent were small, 41 percent medium and 24 percent large-scale. With regard to origin, the sample was weighted in favor of new start-ups, which accounted for 61 percent, with the balance composed of privatized enterprises. Finally, 43 percent of the enterprises had received assisted through USAID, 29 percent through other donors, and 39 percent were not assisted. (In a number of cases enterprises received assistance from two or more donors, which is why the total exceeds 100 percent.)

The results of the enterprise survey generally confirm the slow pace of restructuring of large privatized enterprises, especially those in the manufacturing sector. For example, only a fraction of manufacturing enterprises (17%) increased the quality of production, although 44% faced an increase in competition. Privatized, large and manufacturing enterprises are the lowest performers within their respective profiles with respect to both quality improvement vis-à-vis domestic competitors and attractiveness of workforce compensation relative to competitors.

The high percentages of privatized (71%), large (55%) and manufacturing (50%) enterprises reporting an employment decrease can be contrasted with the much lower percentages of such enterprises reporting changes in their primary product line (23%, 9% and 28%, respectively) or a discontinued product line (29%, 27% and 22%, respectively). The fact that privatized, large and manufacturing firms that have changed their primary product line or discontinued a product line are in the minority may be taken to imply that fundamental restructuring is proceeding slowly.

New-start enterprises in Kazakhstan tended to be associated with an absence of arrears, while the opposite is true of privatized enterprises. Nonetheless, a majority of enterprises in all categories is free of arrears. This may reflect the fact that Kazakhstan was an early stabilizer, and has been relatively successful in imposing a hard budget constraint on former state enterprises. According to official statistics, however, payment arrears continue to be widespread.

2. Latvia

A total of 45 enterprises were surveyed in Latvia. Of these enterprises, 52% were in services and the balance was divided between manufacturing (26%) and agribusiness (22%). Enterprise size was divided fairly evenly with 33% being small, 37% medium and 30% large-scale. With regard to origin, the sample was weighted in favor of privatized enterprises, which accounted for 57%, with the balance composed of new start-ups. Finally, USAID had provided technical or financial assistance to 30% of these enterprises surveyed, other donors provided assistance to 37% of the sample, and 48% were not assisted. (In a number of cases enterprises received assistance from two or more donors, which is why the total exceeds 100 percent.)

Latvian enterprises were characterized by the absence of arrears. The only enterprise with arrears was a medium-sized, privatized agribusiness. Services outperformed both agribusiness (10% v. 50%) and manufacturing (15% v. 50%) in terms of the proportions of enterprises that scored well on measures of enterprise profitability contained in the survey.¹³

According to the enterprise survey, the service sector has been slower to restructure than the agribusiness or manufacturing sectors. While 65% of service enterprises had an increase in competition only 38% responded by increasing their product quality in relation to domestic competitors. In agribusiness, 40% had an increase in competition and 30% reported increasing their quality. In manufacturing, the increase in competition was balanced by an increase of product quality (39% each). Small-scale enterprises had a 67% increase in competition but only 33% responded by increasing their quality. New start-ups reported a 62% increase in competition but had a 43% increase in quality while 44% of privatized enterprises faced increased competition and 32% raised their quality.

Both agribusiness and manufacturing had a large decrease in their employment (40% and 39% respectively) while only 8% of services reported a decrease. Privatized enterprises reduced their employment by 40% while no new start-ups reported any employment shedding since formation.

3. Romania

A total of 46 enterprises were surveyed, of which 29.5% were agribusinesses (including producers, processors and other food services); 36.7% were manufacturers; and 32.6% were services (excluding financial services). Definitions of enterprise scale followed those prevalent in Romania: 41.3% were small companies, with 50 employees or less; 36.9% were medium-scale, with between 51 and 250 employees; and 21.7% were large companies, with 251 or more employees. All enterprises were privately owned, and operating in competitive markets; 34.7% of the companies surveyed had been privatized, and 65.2% were new start-up enterprises. The sample also was stratified by receipt of donor technical or financial assistance: 36.2% had received

¹³ To score well on these proxies, an enterprise had to have reported engaging in enterprise promotion activities (including advertising or participation in trade fairs); purchasing outside business services; and acquiring land, fixed assets or equipment utilizing external financing at least in part. (see section III for a description of the enterprise performance measures utilized in this evaluation.)

direct assistance from USAID implementors; 25.5% had received assistance from other donors; and 38.3% had received no donor assistance. (The numbers do not add to 100% because some enterprises received assistance from both USAID and other donors.)

A majority (57%) of Romanian agribusinesses reported that their domestic competition had increased, and 50% reported that their quality had increased in response to competitive pressures. In contrast, only 28% of Romanian manufacturers, and 24% of services companies, reported facing an increase in domestic competition; likewise, only 28% of manufacturers and 18% of services increased quality in comparison to domestic competitors. Agribusinesses also tended to be relatively flexible in production, with 42.9% having made a shift from one primary product line to another, as compared with manufacturers (17%) and services (35%).

Services generally (94%) tended to remain free of serious payment arrears. By way of contrast, about one-third of the agribusinesses and slightly less than one-third of manufacturers had built up serious payment arrears. Services out-performed manufacturers (30% v. 17%) in terms of the proportions of enterprises that scored well on measures of enterprise profitability contained in the survey.¹⁴ But not a single agribusiness was ranked as a high performer according to this measure.

Large Romanian enterprises tended (44%) to score well on proxies of enterprise profitability, as compared with medium-scale enterprises (12%) and small-scale enterprises (10%). Medium-scale enterprises tended (41%) to be characterized by arrears build-ups. The vast majority (90%) of small-scale Romanian enterprises tended to be free of payment arrears.

Managers of new start-ups in Romania tended to report that they had increased product quality in response to competitive pressures. But privatized Romanian enterprises tended not to have increased product quality.

4. Russia

Of a total of 49 enterprises surveyed, 41 percent were in manufacturing, 31 percent in services and 28 percent in agribusiness. With regard to size, the sample was weighted in favor of small enterprises, which accounted for 43 percent, with 28.5 percent each of medium and large-scale enterprises. With regard to origin, privatized enterprises comprised 53 percent of the sample, with start-ups comprising the balance. Finally, 43 percent of the enterprises received assistance through USAID, 28.5 percent received assistance through other donor sources, and 33 percent received no assistance. (In some cases enterprises received assistance from two or more different donors, which is why the percentage for donor assistance exceeds 100 percent.)

Because of Russia's vast size, the enterprise survey necessarily focused primarily on a single region, Rostov-on-Don oblast. At the same time, the survey was not limited to enterprises in Rostov oblast because none of the 27 enterprises that participated in USAID's PIES and FMA activities were located in Rostov oblast. Of the 49 enterprises surveyed, 5 were located in Vladimir oblast, with the balance located in Rostov-on-Don and the surrounding region. The 5

¹⁴ See footnote 1 of this section.

enterprises in Vladimir oblast were selected based on the consideration that each had received assistance under one or more post-privatization support programs, namely FMA, PIES and the IESC. This selection criterion drove the characteristics of the Vladimir sample. In particular, all 5 of the enterprises surveyed in Vladimir oblast were privatized, large and engaged in either heavy industry (4) or food processing (1). Thus, the remaining selection criteria were applied exclusively to the sample of enterprises in the Rostov region.

Russian agribusiness enterprises tended to score poorly on proxies of enterprise profitability, although a significant proportion (50%) of agribusiness managers reported that their product quality had increased as their markets became more competitive.¹⁵ The vast majority of Russian manufacturers sampled (84%) exhibited a serious build-up of payment arrears; only 4% reported an increase in product quality in response to increased competition. Services enterprises tended (73%) to be free of payment arrears and to score well on proxies of enterprise profitability. Presumably one reason the service sector is less troubled by arrears than manufacturing is that service enterprises are closer to the consumer and consequently have a higher proportion of cash sales in their revenues.

Large-scale Russian enterprises tended (72%) to exhibit serious payment arrears build-ups, but tended still to perform well on proxies of enterprise profitability. One plausible conclusion from this result is that many arrears problems may persist because of failure to enforce contract and bankruptcy laws. Medium-scale Russian enterprises, on the other hand, tend to score poorly on proxies of enterprise profitability. With regard to enterprise origin, privatized Russian enterprises tend (62%) to exhibit arrears, whereas new start-ups tend (74%) to be free of them. This may reflect the fact the new Russian firms naturally tend to gravitate toward businesses characterized by a high proportion of cash sales in their revenues (for example, services and consumer goods production). Privatized firms have less flexibility, especially if they sell most of their output to insolvent manufacturers or the government, and often have no choice but to let customers delay payment or pay in barter or money surrogates.

The results of the enterprise survey generally confirm the slow pace of restructuring and difficult financial position of large privatized enterprises, especially those in the manufacturing sector. For example, a large majority of privatized enterprises, large enterprises and manufacturers reported having arrears of various kinds, whereas the majority of new start-ups, small and medium-sized enterprises and service and agribusiness enterprises were free of arrears.

D. Findings and Conclusions

1. Agribusiness

Agribusiness, more than any other than other sector, continues to be constrained by an extremely hostile enabling environment in the economies surveyed, with the possible exception of Latvia. This has harmed de-collectivized agricultural production in particular, as has the preponderance of insider-controlled farms, which have tended to resist restructuring. Nonetheless,

¹⁵ See footnote 1 of this section.

good opportunities exist in agribusiness services, such as food processing, storage, distribution and retail sale.

Confirmation of these findings derives from the enterprise survey. Agribusiness enterprises overall tended to score poorly on proxies of enterprise profitability; the shift from state to private customers hit agricultural producers especially hard in terms of a build-up of serious arrears. Agribusiness services, on the other hand, tended to respond to increased competition by increasing product quality if they were medium-scale, or if they were joint-stock companies controlled by outsiders.

As part of the survey, agribusiness managers also were asked to rank the impact on profitability of factors in the economy beyond their control. The results tended to confirm that there were striking differentials among sectors in the degree to which the business environment adversely affected enterprise performance. In every country in which the survey was carried out, for example, more agribusiness managers reported that their companies were severely adversely affected by inflation and high interest rates than did managers of manufacturing and services enterprises. As for the enabling environment, fully 79% of Romanian agribusiness managers, 64% of Russian and Kazakh managers and 50% of Latvian managers listed taxes and regulations as seriously adverse factors affecting their enterprises' performance.

One implication of this finding is that for agribusiness development, higher priority should be given to pushing for effective implementation of economic stabilization policies and reform of the enabling environment as it affects agribusiness.

2. Manufacturing

As a residual of central planning, manufacturing was characterized by large, inefficient behemoths that tended to produce very low-quality products regardless of market demand or cost. Six or seven years into the transition this industry profile still prevails, although it is changing rapidly in selected countries, areas and subsectors. The leader of change has been economic stabilization, and imposition of a hard budget constraint on enterprises, as has occurred in Latvia to a large extent, and to varying degrees in the other three countries. In every country, however, growth opportunities exist for manufacturing enterprises capable of taking advantage of them particularly in light manufacturing.

The survey results tended to confirm the slow pace of enterprise restructuring that has occurred in the manufacturing sector. Manufacturing enterprises surveyed during the field work generally tended to exhibit a build-up of serious payment arrears, and privatized manufacturers scored poorly on proxies of enterprise profitability. There were bright spots, however: New-start, medium-scale manufacturers, in particular, tended to report that their product quality had increased in response to increased domestic competition.

Regarding the adverse economic impacts on their enterprises' profitability, 50% of Romanian manufacturing-company managers surveyed tended to rank inflation as a serious problem, as did 28% of Kazakh, 25% of Russian, and 15% of Latvian manufacturing-company managers. Interest rates were ranked as a problem most often by manufacturers in Russia (40%),

with significant proportions of Romanian (33%), Kazakh (17%) and Latvian (15%) managers of manufacturing companies also registering interest rates as a serious concern. Taxes and regulations were regarded by fully 70% of Romanian and Russian manufacturers, 61% of Kazakh manufacturers, and 38% of Latvian manufacturers, as a serious impediment to their profitability.

The implication of this fairly consistent country ranking of adversity is that restructuring of the manufacturing sector lags in countries in which stabilization policies have been less effective, and where reform of the enabling environment has been slow or piecemeal.

3. Services

Services were either ignored, hindered or outlawed under Marxism, with the odd result that now the scope for growth in this sector is enormous. The evaluation team found that growth in the services sector was indeed brisk in all four countries, led by new start-ups and enterprises privatized under small-scale privatization.

Again, the survey confirmed this sectoral analysis. Services companies tended to be free of payment arrears, and to score well on proxies of enterprise profitability. New start-up services generally had increased product quality in response to competition, while privatized services generally had not, with the exception of small, privatized services.

Concerning the observed impact of economic factors on enterprise profitability, managers of services companies surveyed appeared to be less concerned by inflation and high interest rates than managers in other sectors. These results suggest that services companies are profitable in part because they tend to rely on direct cash sales to consumers, and can pass along price increases accordingly. But services managers tended to rank taxes and regulations as serious problems more often than managers in any other sector. Fully 80% of services managers in Romania and Russia, 64% in Kazakhstan and 54% in Latvia ranked taxes and regulations as a serious impediment to profitability.

IV. Successful Private Enterprise Strategies

The scope-of-work for this evaluation states that the contractor should, first, assess where "accelerated growth and development of private enterprises" seems to be taking place in the ENI region; and second, identify important explanatory or contributing factors to such growth. Sections II and III of this report have been devoted to assessing the sources of growth in the four countries surveyed, by sector and subsector, enterprise scale, method of founding (ie., privatized or new start-ups) and ownership structure; and to identifying the constraints to that performance posed by stabilization policies and the enabling environment. But this is only half of the story, because whether enterprises succeed or fail ultimately depends, within the bounds of the business environment that they face, on their own actions.

This section examines the question of what microeconomic factors have been associated with successful enterprise growth and development in the ENI region. In other words, what were the enterprise strategies and behavioral characteristics that led to success versus stagnation and failure? The answer is important to managers of enterprises in the economies in transition who would like to emulate successful strategies, as well as to donor officials, who need to know what works so they can design and implement better enterprise assistance programs. The evaluation team relied on data derived from the enterprise survey to develop a profile of enterprise behavior associated with success.

The evaluation team's approach to measurement of enterprise performance is presented first. This is followed by analysis of the extent to which enterprise behavioral characteristics are correlated with successful enterprise performance, utilizing pooled cross-sectional stratified data. The final section presents findings and conclusions in the form of sectoral profiles of successful enterprises.

A. Measuring Enterprise Performance

A key difficulty for the survey instrument was to develop objective measures that could separate "successful" enterprises from "surviving/stagnant" ones in an environment in which managers are well known to avoid delicate questions that might be of interest to tax authorities or mafia racketeers. To accomplish this, the survey posed a series of indirect questions about payment arrears, external sources of investment financing, expenditures made on advertising or outside business services, and perceptions about the trend of product quality in comparison to that of competitors. The results were developed into several separate measures of enterprise performance. The performance measures were:

- ! **Absence of Serious Payment Arrears.** Arrears were considered serious if they were tax, debt or wage arrears of any duration; or arrears in making payments to suppliers in excess of 3 months. A positive score indicated no such arrears.
- ! **Proxies of Enterprise Profitability.** To receive a positive score on these proxies, an enterprise had to have reported engaging in enterprise promotion activities (including

advertising or participation in trade fairs); purchasing outside business services; and acquiring land, fixed assets or equipment utilizing external financing at least in part.

Increase in Product Quality. Enterprise managers were asked to rank their product quality in comparison to their domestic competitors, at founding/privatization and currently. In those cases in which there was an increase in the ranking, the enterprise was given a positive score.

It should be noted that these measures were derived from a series of indirect questions that were not revealed to either the surveyors or the enterprise managers surveyed as being the basis for deriving enterprise performance measures.

B. Pooled Cross-Sectional Data Analysis

Analysis of microeconomic factors associated with successful enterprise performance was based on data derived from the enterprise survey. Data from the four countries were analyzed in the aggregate and in pooled cross-sections. Data analysis techniques involved the straightforward calculation of simple correlation between individual enterprise characteristics and the three separate measures of enterprise performance.¹⁶

It was determined early on that pooling enterprise data by country was of limited usefulness, because the sample from each country contained enterprises from such widely varying backgrounds (ie., stratified by sector, scale, method of founding and recipients of donor assistance). Accordingly, the data from all four countries were pooled by stratification characteristic, a methodology which yielded much more robust results. Salient results of this exercise are summarized here, by enterprise characteristic and sector.¹⁷

! Employment Policy

Among the key elements to successful agribusiness performance were the ability to shed redundant labor while improving workforce compensation packages for retained employees and new hires.

The survey results also reflected the retrenchment that had occurred in the bloated manufacturing sector, as management engaged in employee layoffs associated with the build-up of arrears.

Services enterprises behaved much more like normal companies: increases in their workforces were associated with strong performance on all three measures.

Product Line Flexibility

Many agribusinesses, especially large, privatized ones, found themselves in the position of having to change their primary product line to adapt to the new market economy.

¹⁶ Only correlation relationships significant at the 90% level or higher were analyzed. Significant correlation levels were identified utilizing Student's t-test and cross-checked with Chi-squared tests.

¹⁷ See Annex B for more detailed description of this analysis.

Among manufacturers, enterprises that demonstrated the ability to switch primary product lines in response to market demand and cost considerations were able to out-perform those that were more rigid.

Services that switched primary product lines in response to demand and cost considerations also appeared more profitable than their competitors.

Responsiveness to Competition

Agribusinesses facing increased competition tended to build up serious arrears.

For manufacturers, increased domestic competition appeared to provide the motivation to improve performance, and this benefited their competitiveness vis-à-vis international competitors as well.

In the services sector, increased quality was associated with increased competition; and increased quality in comparison to domestic competitors also tended to produce increased quality vis-à-vis international competitors.

! Customer Base

Agribusinesses that had depended on the state as a primary customer tended to exhibit arrears build-ups associated with making the shift to private customers.

Making the shift from the state to private customers was associated with increases in quality among new-start manufacturers.

Shifting from the state to private customers also was an indicator of success among services enterprises.

! Sources of Financing

Successful agribusinesses that had relied primarily on state financing tended to shift to private financing sources, including retained earnings. The next step appeared to be to make the transition from retained earnings to other, private sources of financing.

Large-scale manufacturers that shifted from dependence on state loans to private sources of financing, including retained earnings, tended to out-perform their competitors. Those that were free of arrears tended to be able to shift from relying primarily on retained earnings to private, external sources of financing.

Continued reliance on state loans was a negative indicator of enterprise success among services enterprises.

! Adoption of Western Business Practices

Agribusinesses that adopted and implemented Western management and financial management practices, and marketing techniques, tended to outperform those that did not. Manufacturers, particularly privatized manufacturers, that adopted Western business practices tended to outperform their competitors.

The importance to enterprise performance of adopting Western business practices such as management, financial management and marketing, was most evident in the services sector.

! Adoption of Cost Controls

For agribusinesses, adoption of cost controls appeared to be associated with extraordinary measures to reduce losses, rather than pro-active measures to improve profitability. Adoption of cost tracking and budgeting systems was not significantly correlated with measures of performance of the manufacturing and services enterprises in the current sample.

! Forward-Backward Linkages/Strategic Alliances

Although most agribusiness managers recognized the importance of forward and backward linkages, it appeared as if unreliable suppliers and clients negatively affected their performance.

Linkages and strategic alliances were considered important by manufacturing enterprises, although as in the agribusiness sector, these relationships appeared to be of mixed utility in terms of fostering enterprise profitability.

Establishment of business linkages and alliances was a robust indicator of enterprise performance among services enterprises.

! Form of Ownership/Corporate Governance

The form of ownership and consequent corporate governance of agribusinesses had a great deal to do with enterprise performance. Direct or outsider corporate control was strongly correlated with success.

For manufacturers, direct control by single owners or partners, or indirect control by an outside group of owners, was correlated with enterprise success; insider-controlled joint-stock companies tended to run up serious arrears.

As in the other competitive sectors of the economy, form of ownership was an important indicator of enterprise performance in the services sector; sole proprietor and partnerships tended to fare well in comparison to joint-stock companies.

C. Sectoral Profiles of Successful Enterprises

These survey results can be utilized to construct profiles of successful enterprises in sectors in which competition is rising, and some enterprises are increasing both sales and market share. The results suggest the following such profiles, by primary sector:

Agribusiness

- **Agribusiness services**, like food processing, storage, transport, distribution and retail sales companies, look like the best prospects in the agribusiness sector for growth and profitability.
- Agribusinesses that have demonstrated **flexible employment policies**, by shedding redundant labor and improving workforce compensation packages for retained and new-hire employees, tend to be the most successful.
- Large, new-start agribusinesses can be successful, and in particular, have tended to respond to **increasing competition** by increasing product quality.
- Medium-scale and new-start agribusinesses that have changed their **primary source of financing** from state loans to other, private sources are likely to be profitable, as are large and privatized agribusinesses that have developed private, external sources of financing.
- Privatized agribusiness services and small agribusinesses generally that **adopt Western business practices** are likely to demonstrate improved enterprise performance.
- Privatized companies that institute **cost tracking and budgeting systems** tend to avoid serious payment arrears.
- New-start and medium-scale agribusinesses that can establish reliable **forward/backward linkages and strategic alliances** are more successful.
- **Ownership form** is critical: sole proprietor/partnerships and outsider-controlled joint-stock agribusinesses are the most successful forms.

Manufacturing

- **New-start** and **medium-scale manufacturers** appear to be the best prospects in the sector for increased growth and profitability.
- Manufacturers that demonstrate **product line flexibility** in response to market demand and cost considerations are able to outperform those that are more rigid.
- Manufacturers facing **increased competition** tend to respond by increasing product quality and avoiding arrears.
- Manufacturers that shift their **customer base** from the state to private customers tend to increase product quality and avoid arrears.
- Large manufacturers can be successful if they shift their **primary source of financing** from the state to other, private sources, especially if they are able to develop private, external sources of financing.

- Privatized manufacturers that adopt **Western business practices** tend to be successful.
- Manufacturers that develop **linkages to suppliers** tend to be better performers.
- **Ownership form** is critical to the success of manufacturers: direct control by single owners or partners, or indirect control by an outside group of owners, is correlated with successful performance.

Services

- **Services enterprises** generally perform well, especially **small-scale firms** and **new start-ups**.
- Medium-scale services that are **increasing employment** tend to score well on all measures of profitability.
- New-start services that demonstrate **product line flexibility** in response to market demand and cost considerations are able to outperform those that are more rigid.
- **Increased competition** is associated with increased quality and profitability of services enterprises, especially medium-scale companies.
- Shifting the **customer base** from the state to private customers is associated with successful services.
- Adoption of **Western business practices** was a critical element of success among services enterprises.
- Medium-scale services that established **business linkages and alliances** tend to be successful.
- For services, as with the other competitive sectors, **form of ownership** is critical: sole proprietor/partnerships tend to fare the best.

V. Assessment of USAID's Direct Enterprise Assistance

The scope-of-work for this evaluation states that it should allow USAID to assess overall progress made within the ENI region in meeting its Strategic Objective 1.3, "to accelerate growth and development of private enterprises." In particular, the evaluation team has been asked to (1) "identify the areas and causes of enterprise growth in the ENI region;" the results of this exercise have been presented in sections II, III and IV, above. The scope-of-work also asks the contractor to (2) "assess the relationships (if any) between such growth and USAID assistance efforts;" and (3) "examine implications for future program priorities as well as for U.S. commercial interests." The scope goes on to restrict the assessment to the impacts of direct programs of assistance to private enterprises.

To accomplish the latter two tasks, in each of the four countries the evaluation team first met with Mission staff to examine the design and implementation of USAID's direct enterprise assistance program, in terms of targeting strategy, midstream adjustments made and their rationale, and complementarity with other USAID activities and those of other donors. This was supplemented by a series of questions in the enterprise survey about the impact of direct USAID and other donor assistance. Data analysis involved examining whether there was significant correlation between assistance types that were ranked by enterprise managers as very important or critical, and the enterprise's subsequent performance, as measured by independent criteria. Recommendations are summarized as suggested "best practices" for targeting assistance. An afternote reviews why enterprise surveys are an essential part of assessing the impact of direct enterprise assistance.

A. Targeting Strategy

USAID Missions have tended not to promulgate formal strategies for the targeting of their direct assistance to private enterprises in the ENI region. This is not to say, however, that the Missions have not followed any strategies for targeting for such assistance. Allocated resources are limited, and so their expenditure must be prioritized among several competing proposed activities. Missions must show that their strategic objectives are being achieved and if possible exceeded, and so Mission Directors will tend to back those proposed activities with the greatest potential payoff. Mostly the judgements about which activities and activity designs are likely to have the greatest relative payoffs are based on the field experience that development professionals have accumulated in various countries over the years. All this implies that targeting strategy, although it may not be explicitly articulated, plays an important role in the promulgation of direct enterprise assistance activities.

There are several different methods that may be utilized to target direct assistance to enterprises, each with its own logic, implications and trade-offs. A number of these are reviewed in this section, illustrated by references to specific methods being employed in the four Missions visited. The goal of the section is to review the strategies in terms of their implications regarding the replicability and sustainability of the impact achieved.

Although supposedly anathema to economists, most USAID contractors or grant awardees charged with providing direct technical assistance and training to private enterprises will say that the best strategy is to target enterprises that are likely to succeed. The reasoning for trying to "pick winners" is straightforward. It is perceived that the impact of the technical assistance and training would be lost if provided to enterprises that eventually fail, calling into question its impact on private sector development. So, assistance targeting usually involves trying to predict which enterprises will eventually succeed, utilizing readily observable criteria.

Of course, even if the enterprise fails, it is the employees, both management and workers, who are trained, and they will carry those skills with them to other jobs. Nonetheless, it is true that much of the impact of the assistance will be dispersed into the economy if the enterprise closes, and therefore will be untrackable for reporting purposes. And much of the impact will be lost, either because it was enterprise-specific or because the employees remain unemployed for prolonged periods after being laid off.

A more basic issue with "picking winners" has to do with replication of the impact of the assistance. In other words, how can providing intensive technical assistance or training to employees in 40 or 50 enterprises (a fairly costly project by any standard), affect the growth of the private sector in an economy in which there are thousands or hundreds of thousands of enterprises? In other words, is it replicable and sustainable, and if so, how? This question leads to consideration of supplementary strategies for targeting enterprise assistance, a number of which are reviewed briefly in what follows.

1. Privatized enterprises versus new start-ups

One strategic question is whether to target assistance to privatized enterprises requiring post-privatization restructuring, or to new start-ups looking to grow. It is not entirely clear *ex ante* whether "picking winners" would favor working with privatized enterprises or new start-ups, because although former state enterprises are subject to excessive rigidities, there is generally a history of high failure rates among new start-ups. There is also the possibility that privatized enterprises in certain sectors, conforming to certain profiles, may be less likely to fail than others. (The survey results from this evaluation, reviewed below, shed light on these and similar questions.)

In practice, decisions as to which type of enterprise Missions would work with appear to have depended on a number of factors. Early on in many comprehensive privatization programs there is often political pressure from ministry counterparts to provide some sort of post-privatization restructuring assistance to large enterprises in order to defuse opposition to the privatization process. And those enterprise managers who can get their bids "first in the door" may have a better chance of succeeding in getting assistance.¹⁸ But it is also true that post-privatization restructuring of large enterprises can become an expensive proposition, so that

¹⁸ According to the director of the Rostov regional office of the IESC, for example, in the first 2 years of the office's operations, about 90 percent of the consulting assignments flowed through the Local Privatization Center, an affiliate of the Russian Privatization Center in Moscow, which was supported by USAID. As a result, the office had no choice but to concentrate assistance on privatized enterprises.

those Missions with relatively restrictive budget allocations have tended to choose other strategies for targeting direct assistance. Missions with relatively liberal allocations have tended to be the ones that could afford post-privatization assistance with sizable amounts spent per enterprise. This appears to have been the case, for example, in Russia in the early transition years, although with smaller budget allocations in recent years, the Mission has shifted its emphasis decisively in favor of SMEs.

2. Small- and medium-scale versus large

Another strategy gaining considerable credibility among Missions is to target direct enterprise assistance to small- and medium-scale enterprises (SMEs). It is certainly true that in the United States, small business is extremely productive in terms of new business creation and employment generation. Survey results tend to confirm that this can be a more effective strategy than assisting large, privatized enterprises. But much of the dynamism of the U.S. SME sector is based on a conducive enabling environment, raising the question whether USAID assistance to private sector development should not focus first on improving the enabling environment, and only secondarily on providing direct assistance to enterprises. This has been the explicit strategy followed in the Kazakhstan Mission, for example. (Some good responses to this question are discussed below under the section on advocacy.)

As a method to target assistance, moreover, there are difficulties with specifying SMEs as the basic selection criterion. The definition of SME may be too broad — up to 250 employees is the definition of SME in three of the four countries of this survey — to be of much use in "picking winners." The failure rate for SMEs tends to be high (reportedly very high in Russia, for example). Because of the exigencies of privatization processes, moreover, many SMEs are privatized enterprises controlled by insiders, making them unlikely bets to succeed (see the results of the enterprise survey presented in section III, above). And again, how can intensive TA provided to a limited number of SMEs generate private enterprise development among the thousands or hundreds of thousands of companies in the economy at large?

What seems clear is that, even if the choice is made to provide support only to SMEs, there will need to be subsidiary targeting criteria. This leads to the discussion below of targeting by sector or subsector, and of "industry leaders" and "retail versus wholesale assistance providers."

3. Sector or subsector targeting

Findings of this evaluation concerning high versus low-performing sectors and subsectors are presented in section II, above. Briefly, if one were to try to target enterprise assistance toward the sectors or subsectors most likely to succeed based on these findings, although these would vary from country-to-country, an initial shortlist would include food processing, storage, distribution and retail sale; light manufacturing; and non financial services generally. These markets are where newer and more flexible enterprises are found, at least in part because they tend to be closer to the consumer and hence are less dependent on barter arrangements.

But the results of the enterprise survey, reviewed in section III, also indicate that (1) targeting on sector or subsector criteria alone may be too restrictive, because there are some good bets outside these markets; and (2) even within high-performing sectors and subsectors, subsidiary selection criteria should be applied. So, for example, enterprises founded as sole proprietorships or partnerships tended generally to perform well, whereas insider-controlled joint-stock companies did not. Medium-scale, new-start manufacturers were better bets than large, privatized ones. Privatized services, with the exception of small companies, tended to fare poorly, as did insider-controlled agribusiness services. In addition, sector or subsector targeting in and of itself would not address the questions already raised above about replicability and sustainability of intensive technical assistance and training.

4. Retail versus wholesale providers

One means to target assistance to enterprises involves providing training through "wholesale" rather than "retail" providers. The concept here is to focus mainly on broader training and information dissemination, routing the assistance through industry associations or business services providers. Trainers are trained, and so they can continue training once the activity ends, making the impact of the assistance sustainable in that sense. In addition, routing the grant assistance through industry associations can be a means of strengthening them institutionally.

Broad-based training seems to make sense in sectors or subsectors where privatization and post-privatization restructuring have run their course, and the emphasis has shifted to SMEs and new start-ups. More "wholesale" approaches to disseminating business skills may be desirable if the focus shifts from re-training the employees of privatized enterprises to a strategy that relies on broader promotion of entrepreneurship.

One potential problem with the "wholesale" approach, however, is that it mixes means with ends. If channeling of broad-based training through business associations or private service providers is determined to be the best means to provide direct enterprise assistance, unless there are thriving institutions of that type already in existence, the activity will have to include an effort to build such institutions as one of its ends. This presents an acute problem in republics of the former Soviet Union, where civil society was entirely wiped out, and in which today private business associations are still rare and rudimentary. The difficulty is only compounded if the enterprises that are potential members or clients of the institution to be created have yet to achieve profitability. There may be additional reasons why industry associations are desirable (including development of their capacity for advocacy, reviewed in the next section), but here again, the shift in goals may relegate enterprise development activities to secondary importance.

One final difficulty with activities that provide broad-based training as opposed to intensive technical assistance, including the "wholesale" approach, is that their popularity may derive from restricted budget allocations rather than proven effectiveness in terms of enterprise development. In other words, broad-based training promises the capacity to train many more enterprise managers at lower cost; but the issue, of course, is not how many are trained, but whether the training leads to their later success. (See the afternote to this section "*Why Enterprise Surveys are Essential*" for further discussion of this issue.)

5. Industry leaders

The concept of targeting intensive technical assistance and training to "industry leaders" addresses the question of broad-based sustainability head-on, while retaining the goal of improving enterprise performance as the primary goal. The strategy is to target and develop successes among a core group of clients, struggling yet competitive, that will receive intensive technical assistance and training. As the core group begins to increase profitability and market share, their competitors must emulate their successful business practices in order to survive. For example, competitors will have direct incentives to employ persons with business skills that will allow them to compete more effectively with the industry leaders, and so demand is increased for access to broader training and information dissemination programs. More generally, competitive forces are the means by which the intensive technical assistance and training provided to a limited number of core enterprises is replicated in their direct markets. As these markets grow, their backward and forward linkages will also increase business for their suppliers and clients.

The core group of "industry leaders" may also be chosen in part because they are competing in strategic sectors with larger importance for economic growth and development. The assistance may be targeted, for example, toward private enterprises that are attempting to compete with monopolistic state-owned or privatized enterprises which continue to dominate important points of the production and marketing chain, but are inefficient and costly. (An example would be technical assistance provided to encourage competition among private transporters in Kazakhstan.)

A final role for "industry leaders" may be to advocate the policy and institutional changes that are needed to make their industries more competitive and profitable. This is discussed further below, in the section devoted to complementarity.

6. Broad-based and sustainable impact

The forgoing suggests that direct enterprise assistance is much more likely to be replicated and sustained if it is provided to enterprises in markets that are growing and profitable, because it is market competition that is the main engine driving replication of successful business practices. Without replicability, the impact of direct assistance to enterprises cannot be broad-based. Likewise, the impact of direct assistance is less likely to be sustained in markets that are not growing and profitable.

Based on the results of this survey, enterprise assistance is more likely to be replicable if it is provided to enterprises that are working in dynamic sectors of the economy (like agribusiness services, light manufacturing or (nonfinancial) services). In terms of sustainability, the most successful enterprises are likely to be new start-ups, although privatized companies with clear lines of corporate control may be considered. They are also likely to be small or medium-sized companies with established and dependable relationships with suppliers and clients (or, if this is not possible, will be integrating upstream and downstream production into their own operations). And they will be able to demonstrate flexible product-line and employment policies; that their customers and sources of financing have shifted from the state; and that they have begun to implement some of the fundamentals of Western business practices.

B. Complementarity among USAID activities and with other donor activities

There are a number of areas in which complementarity of USAID's direct enterprise assistance activities with others within the USAID portfolio, or with those of other donors, should be encouraged. These are reviewed briefly in this section.

1. Linkages to Financing

Complementarity among direct assistance programs should be reinforced by Mission policies wherever practical. One example relates to financing. Most implementors agree that without access to financing, technical assistance and training is of much less immediate importance to enterprise managers. And, although in a few countries in the ENI region, commercial bank financing is becoming a viable option for many enterprises, for the most part this evaluation has found that commercial banking is severely underperforming its potential as a force for development of private enterprise.

This raises the question whether direct technical assistance and training can be effective in countries or regions in which there simply is no realistic access to commercial financing, and where donor-funded financing options have yet to be developed. The answer, based on interviews in Latvia in particular, where there was a significant gap between the period when the technical assistance and training was provided and the creation of an enterprise fund that could follow through, is that the impact of the assistance is blunted significantly by the lack of complementarity that can be achieved when both facets of enterprise assistance are present.¹⁹

To the extent that USAID activity managers have fostered and encouraged collaboration between USAID implementors that provide technical assistance and training, and USAID-financed enterprise funds, as is already done in several ENI Missions, the synergies created have had a beneficial effect on the impact of both forms of assistance. It is also the case that there may be no better cross-check of the value of the grant assistance provided than the extent to which projects turned into donor financing agencies by the technical assistance and training providers are approved. On the other hand, Missions have been slower to encourage collaboration with financing agencies sponsored by other donor agencies, especially the EBRD's small business funds. Although the United States is still the largest contributor to the EBRD's base capital, the EU's Polish and Hungarian Assistance for the Restructuring of the Economy (PHARE) and Technical Assistance for the Commonwealth of Independent States (TACIS) programs have been much more active in collaborating with EBRD through the provision of direct technical assistance to enterprises under consideration for financing.

2. Advocacy

¹⁹ It is also the case that other donor agencies (IBRD, IFC and to a lesser extent EBRD) have tended to promulgate minimum project sizes in the ENI region that have tilted their private enterprise financing programs decisively in favor of large-scale enterprises. More recently, this trend has been partially reversed, notably with the promulgation of EBRD small business funds.

This evaluation has developed a number of findings relating to the importance of a stable economy and a conducive enabling environment for successful private enterprise development. These findings indicate not only that that economic policy and institutional reform can be the major barriers to enterprise development, but that by wide margins, the enterprise managers surveyed tended to recognize this in those countries and sectors in which policy and institutional reform had suffered the worst lags in terms of effective implementation. This suggests that policy and institutional reform should take priority in such cases, but also that there is ample scope to encourage industry leaders and industry associations to advocate appropriate policy and institutional reforms.

USAID staff are quite familiar with the political economy of reform in developing countries and transition economies, so this will not be reviewed here. Suffice it to say that one means to affect the momentum for policy and institutional reform is to promote advocacy groups with an interest in seeing such reforms enacted and enforced. The potential of the "wholesale approach" in respect to advocacy is that direct assistance to enterprises can be channeled through business associations, and the availability of such services may, in turn, allow those associations to build membership and go on to become successful advocates for positive change. But it is also the case that failing enterprises are a poor basis on which to build effective business associations, and advocacy campaigns. Indeed, it is almost a prerequisite for successful development of business associations that they represent significant groups of "industry leaders" that are successful and growing. This suggests that efforts to advise government officials concerning the need for policy and institutional reform need to be buttressed by simultaneous organization of a group of successful "industry leaders" who can advocate such reform.

Finally, policy and institutional reform can benefit from complementarity with USAID activities that seek to promote U.S. trade and investment. As discussed in section VI, below, there is rarely a more persuasive advocate of the need for reform than the foreign investor, or potential foreign investor.

C. Assessing the Relationship between Direct USAID Assistance and Enterprise Performance

During the survey, those enterprises that had received direct USAID or other donor assistance were asked to identify the specific types of assistance they had received, and to rank the importance of that assistance in terms of their enterprise's subsequent performance. The direct assistance categories were divided into several groupings: Intensive technical assistance; training and information dissemination; private contact-making; and financial assistance, with several sub-headings within each grouping²⁰. Under each sub-heading of assistance they had received, the enterprise managers were asked to rank the importance of the assistance in terms of its impact on their enterprise's performance. This sections presents preliminary analysis of the results of this exercise.

²⁰ The types of assistance enumerated in the survey were grouped so that would be recognizable to the enterprise managers surveyed, and so they may not represent the full complexity of each Mission's program. See the enterprise survey form (Annex C).

1. Frequency v. rankings of USAID assistance utilization, by type of assistance

The following tables show the ranking of importance of technical and financial assistance by managers of USAID-assisted enterprises that were surveyed in the four countries. These frequency tables have been separated by primary sector (agribusiness, manufacturing or services), enterprise scale (small, medium or large) and method of founding (privatized or new start-up). The tables report responses from enterprise managers only if they listed a certain area of assistance as very important or critical to their enterprise's performance.

In addition to substantiating that USAID assistance generally receives positive reviews from recipients, the tables help illuminate those types of assistance that are most often provided, as against those that are ranked as most effective by managers in terms of their enterprise's subsequent performance. Table 1, for example, shows that in the agribusiness sector, although only 29% of enterprises received USAID-promulgated directories, manuals and guides, of those, 83% said that they were of very high value to their enterprises. Likewise, only 19% of the enterprises were assisted with investor contacts and site visits, but 75% of the recipients found them very useful or critical. Similar patterns prevailed in manufacturing and services.

Table 1

Ranking of Importance of USAID Donor Assistance by Enterprise Managers by Primary Sector					
Agribusiness					
	% Firms Receiving Assistance	% Users Valuing Service Highly		% Firms Receiving Assistance	% Users Valuing Service Highly
<i>INTENSIVE TECHNICAL ASSISTANCE</i>			<i>TRAINING AND INFORMATION DISSEMINATION</i>		
Management/Financial Management	33.3%	71.4%	Directories/Manuals/Guides	28.6%	83.3%
Production	33.3%	57.1%	Western Business Practices	47.6%	60.0%
Business Plan Development	33.3%	57.1%	Sources of Finance	23.8%	40.0%
Marketing	28.6%	50.0%	Market Information	19.0%	25.0%
Project Feasibility Studies	14.3%	33.3%			
<i>PRIVATE CONTACT MAKING</i>			<i>FINANCIAL ASSISTANCE</i>		
Investor contacts/site visits	19.0%	75.0%	Loans	38.1%	100.0%
Deal-Making	9.5%	50.0%	Equity Investment	9.5%	100.0%
Trade Shows	9.5%	50.0%			
Manufacturing					
<i>INTENSIVE TECHNICAL ASSISTANCE</i>			<i>TRAINING AND INFORMATION DISSEMINATION</i>		
Management/Financial Management	60.7%	71.4%	Market Information	21.4%	83.3%
Project Feasibility Studies	25.0%	71.4%	Western Business Practices	46.4%	76.9%
Marketing	67.9%	63.2%	Directories/Manuals/Guides	14.3%	75.0%
Production	46.4%	61.5%	Sources of Finance	21.4%	60.0%
Business Plan Development	32.1%	44.4%			
<i>PRIVATE CONTACT MAKING</i>			<i>FINANCIAL ASSISTANCE</i>		
Trade Shows	14.3%	100.0%	Equity Investment	3.6%	100.0%
Deal-Making	3.6%	100.0%	Loans	28.6%	75.0%
Investor contacts/site visits	25.0%	85.7%			
Services					
<i>INTENSIVE TECHNICAL ASSISTANCE</i>			<i>TRAINING AND INFORMATION DISSEMINATION</i>		
Marketing	40.0%	70.0%	Directories/Manuals/Guides	20.0%	100.0%
Management/Financial Management	44.0%	63.6%	Sources of Finance	12.0%	100.0%
Business Plan Development	28.0%	44.4%	Western Business Practices	40.0%	80.0%
Project Feasibility Studies	28.0%	42.9%	Market Information	32.0%	75.0%
Production	16.0%	25.0%			
<i>PRIVATE CONTACT MAKING</i>			<i>FINANCIAL ASSISTANCE</i>		
Deal-Making	8.0%	100.0%	Loans	40.0%	80.0%
Investor contacts/site visits	8.0%	50.0%	Equity Investment	0.0%	n/a
Trade Shows	0.0%	n/a			

Source: LBII Survey

Table 2 groups the same kind of ranking information on the basis of enterprise scale. In the case of small companies, 28% received help with production but only 44% of the recipients found it useful; 16% received help in designing project feasibility studies, but only a fifth of these found that useful. Among medium sized firms, 20% of enterprises were assisted with investor contacts and site visits and all of them ranked the assistance as of high value. Business plan development was ranked as essential by only 42% of medium-scale recipients. Various categories of training and information dissemination were much less frequently provided to both large- and medium-scale enterprises, but received fairly consistently high rankings nonetheless.

Table 2

Ranking of Importance of USAID Donor Assistance by Enterprise Managers by Enterprise Size					
Small					
	% Firms Receiving Assistance	% Users Valuing Service Highly		% Firms Receiving Assistance	% Users Valuing Service Highly
<i>INTENSIVE TECHNICAL ASSISTANCE</i>			<i>TRAINING AND INFORMATION DISSEMINATION</i>		
Management/Financial Management	34.4%	72.7%	Directories/Manuals/Guides	25.0%	100.0%
Marketing	31.3%	70.0%	Market Information	18.8%	83.3%
Business Plan Development	31.3%	50.0%	Western Business Practices	34.4%	81.8%
Production	28.1%	44.4%	Sources of Finance	18.8%	66.7%
Project Feasibility Studies	15.6%	20.0%			
<i>PRIVATE CONTACT MAKING</i>			<i>FINANCIAL ASSISTANCE</i>		
Deal-Making	6.3%	100.0%	Loans	59.4%	94.7%
Trade Shows	6.3%	100.0%	Equity Investment	0.0%	n/a
Investor contacts/site visits	12.5%	50.0%			
Medium					
<i>INTENSIVE TECHNICAL ASSISTANCE</i>			<i>TRAINING AND INFORMATION DISSEMINATION</i>		
Management/Financial Management	52.0%	84.6%	Directories/Manuals/Guides	16.0%	75.0%
Production	28.0%	71.4%	Sources of Finance	20.0%	60.0%
Marketing	48.0%	66.7%	Western Business Practices	52.0%	53.8%
Project Feasibility Studies	24.0%	50.0%	Market Information	32.0%	50.0%
Business Plan Development	28.0%	42.9%			
<i>PRIVATE CONTACT MAKING</i>			<i>FINANCIAL ASSISTANCE</i>		
Investor contacts/site visits	20.0%	100.0%	Equity Investment	4.0%	100.0%
Trade Shows	16.0%	75.0%	Loans	24.0%	66.7%
Deal-Making	8.0%	50.0%			
Large					
<i>INTENSIVE TECHNICAL ASSISTANCE</i>			<i>TRAINING AND INFORMATION DISSEMINATION</i>		
Project Feasibility Studies	35.3%	83.3%	Western Business Practices	52.9%	88.9%
Management/Financial Management	64.7%	54.5%	Market Information	23.5%	75.0%
Marketing	76.5%	53.8%	Directories/Manuals/Guides	17.6%	66.7%
Production	47.1%	50.0%	Sources of Finance	17.6%	66.7%
Business Plan Development	35.3%	50.0%			
<i>PRIVATE CONTACT MAKING</i>			<i>FINANCIAL ASSISTANCE</i>		
Deal-Making	5.9%	100.0%	Equity Investment	11.8%	100.0%
Investor contacts/site visits	23.5%	75.0%	Loans	5.9%	0.0%
Trade Shows	0.0%	n/a			
Source: LBII Survey					

Table 3 shows manager responses on the basis of method of founding of the enterprise. Only 22% of privatized firms received assistance in project feasibility studies, for example, but 80% of those firms found it extremely valuable to them. A much smaller proportion of new start-ups (42%) thought that USAID-financed project feasibility studies were essential to their performance.

Table 3

Ranking of Importance of USAID Donor Assistance by Enterprise Managers by Method of Founding					
Privatized					
	% Firms Receiving Assistance	% Users Valuing Service Highly		% Firms Receiving Assistance	% Users Valuing Service Highly
<i>INTENSIVE TECHNICAL ASSISTANCE</i>			<i>TRAINING AND INFORMATION DISSEMINATION</i>		
Project Feasibility Studies	21.7%	80.0%	Western Business Practices	52.2%	75.0%
Management/Financial Management	52.2%	66.7%	Market Information	13.0%	66.7%
Business Plan Development	26.1%	66.7%	Directories/Manuals/Guides	8.7%	50.0%
Marketing	60.9%	64.3%	Sources of Finance	13.0%	33.3%
Production	34.8%	37.5%			
<i>PRIVATE CONTACT MAKING</i>			<i>FINANCIAL ASSISTANCE</i>		
Investor contacts/site visits	17.4%	75.0%	Equity Investment	4.3%	100.0%
Deal-Making	0.0%	n/a	Loans	13.0%	66.7%
Trade Shows	0.0%	n/a			
New Start-ups					
<i>INTENSIVE TECHNICAL ASSISTANCE</i>			<i>TRAINING AND INFORMATION DISSEMINATION</i>		
Management/Financial Management	45.1%	66.7%	Directories/Manuals/Guides	25.5%	92.3%
Production	31.4%	62.5%	Sources of Finance	21.6%	72.7%
Marketing	41.2%	61.9%	Western Business Practices	41.2%	71.4%
Project Feasibility Studies	23.5%	41.7%	Market Information	29.4%	66.7%
Business Plan Development	33.3%	41.2%			
<i>PRIVATE CONTACT MAKING</i>			<i>FINANCIAL ASSISTANCE</i>		
Trade Shows	11.8%	83.3%	Equity Investment	3.9%	100.0%
Deal-Making	9.8%	80.0%	Loans	45.1%	87.0%
Investor contacts/site visits	17.6%	77.8%			

Source: LBII Survey

2. Correlation of USAID assistance with enterprise performance

Statistical analysis involved examining whether there was significant correlation, by the sub-heading of assistance received, between the assistance ranked as being very important or critical, and independent measures of the enterprise's subsequent performance. The basis for this analysis were cross-sections of data pooled across all four countries and grouped by stratification criteria. Only correlation relationships significant at the 90% level or higher were analyzed. The two measures of performance that were utilized were the composite proxies of enterprise profitability and whether the enterprise had increased quality of its production vis-à-vis competitors.²¹ It should be noted that these performance measures were developed from sections of the survey that were unrelated to the section in which enterprise managers ranked USAID and other donor assistance, and re-iterated that they were derived from a series of indirect questions that were not revealed to either the surveyors or the enterprise managers being surveyed as being the basis for deriving enterprise performance measures.

²¹ With the exception of arrears build-ups, these were the same performance measures that were utilized throughout the evaluation. Build-up of arrears was dropped as an enterprise performance measure in this particular context because it seemed unrelated to the assistance being provided by foreign donors.

Despite the evaluation team's initial caution in respect to applying statistical analysis to assess the impact of USAID assistance on subsequent enterprise performance, overall the results of this analysis tend to indicate a fairly robust relationship between the provision of specific types of direct USAID assistance to private enterprises and the subsequent successful performance of those enterprises. Moreover, the relationships that registered as significant were noteworthy because they were not confined to enterprises in those cross-sections, like small and medium-scale enterprises, new start-ups, or services, determined elsewhere in the evaluation to be relatively high-performing. Instead, they also tended to occur, even to predominate, in cross-sections, like manufacturing and agricultural production, and large or privatized enterprises, which the previous analysis had predicted would be low-performing.

One interpretation of these findings is that it was the USAID assistance that distinguished the high-performing enterprises from others in their low-performing profile, and in fact allowed them to become high performers. Indeed, unless the findings were caused by sample biases or inconsistencies, this is the only plausible interpretation of these results that suggests itself.

The evaluation team is inclined to reject the possibility that sample biases or inconsistencies have affected the result, for the following reasons. As regards possible biases relating to sample selection criteria, staff from each Mission were asked to participate in the selection of enterprises assisted by activities representative of their direct enterprise assistance programs, so the sample should be broadly representative of those programs.²² There may be some biases inherent to the specification of enterprise performance measures, but they are not immediately self-evident. Concerning data inconsistencies, as mentioned in the statistical annex, the survey instrument included more than 20 internal cross-checks of the information provided by enterprise managers; a number of survey forms for which internal inconsistencies could not be resolved were dropped from the sample.

Nonetheless, because the survey results also tend to indicate that enterprises within low-performing sectors or profiles (ie., large, privatized, insider-controlled, heavy manufacturers and agricultural producers, and so on) in general are unlikely to succeed (at least without direct USAID assistance), the question remains whether the assistance provided to a select few is replicable through market competition; and if not, whether its impact can be broad-based and sustainable. Another way of putting this finding is that, to ensure the maximum likelihood that the impact will be replicated and sustained, intensive enterprise assistance should be targeted on subsectors and enterprise profiles most likely to succeed.

There are also other results of this analysis with some important potential implications for the programming of future USAID assistance. One is that the number of enterprises that received intensive technical assistance in this sample considerably outweighs the number that received training and information dissemination. Nonetheless, assistance in the latter category was associated with successful enterprise performance across a much wider range of enterprise

²² Two instances in which the sample was not representative of the Mission's direct enterprise assistance program include the Market-Oriented Farm Support Activity (MOFSA), and the Program for Regional Agribusiness Reform and Investment (PRARI), both in Russia. Louis Berger was the prime contractor in each case, so that these projects had to be excluded from this evaluation.

profiles than in the former. This is also true in the case of USAID facilitation of business deals and contacts which, although quite infrequently provided to enterprises in this sample (Latvian companies received none at all), was cited across a broad range of successful enterprise managers as key to their success. (This finding is explored further below, in the section on linkages between USAID assistance and U.S. trade and investment.)

Finally, although fairly high proportions of the enterprises in this sample had received loans from USAID implementors, and a few had even received equity investments, the benefits of that support in terms of subsequent enterprise performance tended to be narrowly confined to manufacturing enterprises.²³

One question that should be analyzed further relates to the hypothesis that the level and depth of the USAID assistance that is provided is related to subsequent enterprise performance, so that the greater the level of assistance provided to any given enterprise, the greater the likelihood that it performs well subsequently. Unfortunately, this question, although intuitively appealing, is not amenable to statistical examination utilizing information derived from the survey. And USAID does not require regular reporting from USAID implementors, in broadly defined and common categories, about the number of enterprises assisted and amounts spent per enterprise.

The following presents a more detailed interpretation of the preliminary results of the statistical correlation of direct USAID assistance with subsequent enterprise performance.²⁴

a. Intensive Technical Assistance. The enterprises that performed well after receiving intensive technical assistance ranked by managers as very important or critical to their performance tended to be large, privatized or confined to the manufacturing sector. Surprisingly, marketing assistance, although one of the most frequently provided types of technical assistance, was not included among those types of technical assistance correlated with successful enterprise performance.

Instead, what worked most broadly across these enterprise profiles appeared to be project feasibility studies, which was one of the less-frequently provided types of intensive technical assistance. Technical assistance in production expertise was associated with high performance of manufacturers and privatized enterprises; assistance in management, financial management and business plan development was associated with the subsequent successful performance only of manufacturing enterprises.

b. Training and Information Dissemination was correlated with successful enterprise performance across a much broader range of enterprise profiles, despite the fact that it was provided less frequently to the enterprises in this sample than was intensive technical assistance. Training in Western business practices tended to be ranked as very important or critical by managers of successful agricultural producers and manufacturers, and successful large and

²³ The reasons for this are not entirely clear, because the enterprises within the sample that received financial assistance from USAID implementors were fairly evenly stratified among sectors.

²⁴ Further detail is contained in Annex B.

privatized enterprises. This was also the most frequently provided type of training and information provided to enterprises in this sample. A similar pattern prevailed in respect to market information, which was very important or critical to successful manufacturers and privatized enterprises.

Successful manufacturers and agricultural producers also tended to cite directories, manuals and guides disseminated by USAID as key to their performance. Small enterprises, new start-ups and agribusiness service companies that tended to be successful also cited directories, manuals or guides from USAID as very important or critical to their success. Finally, managers of successful privatized and manufacturing enterprises, as well as small-scale enterprises, tended to rank the receipt of information about sources of finance as key to their performance.

c. Private Contact-Making. Again, despite the relatively small proportion of enterprises in the sample that had received USAID assistance in facilitating private business contacts and deals (none of the Latvian enterprises assisted by USAID had received this type of assistance, for example), this category was fairly broad-based in its association with successful enterprise performance. Successful small-enterprise managers tended to rank investor contacts and site visits as very important or critical to their businesses' success, as did managers of successful agricultural producers. Successful medium-scale enterprise managers tended to cite assistance in making business deals, as did managers of successful manufacturers. Managers of successful manufacturers also tended to cite trade show participation as important or critical to the performance of their enterprises.

d. Financial Assistance. Only managers of successful manufacturing enterprises tended to report that financial assistance from USAID, or USAID implementors like the enterprise funds in each country, had been very important or critical to the subsequent performance of their enterprises. The reasons for this are not entirely clear, because the distribution of enterprises assisted by USAID financial support was fairly well stratified among sectors in the sample.

D. Other Issues

1. Women in Development

Among the surveyed enterprises in Romania, the proportion of enterprises reporting an increase in the share of female employees compared with total employees was 59%, as compared with 41% reporting a decrease in the ratio. In the case of Latvia, these proportions were roughly equal. In Russia, the proportion of enterprises reporting that the share of female employees fell was 59%; in Kazakhstan, 69%.

According to results pooled across all four countries surveyed (see the table in Annex B entitled 'Female Employment Share (all countries)'), manufacturers tended to report the greatest decreases in the ratio of female employees to total employees (66% of those surveyed), followed by agribusinesses (57%). A majority of services (63%), however, reported an increase in the ratio. Female employment appeared to be fairly impervious to method of founding, with 55% of

privatized, and 51% of new start-ups, reporting a decrease in the ratio of female to total employees.

Caution should be exercised in analyzing these data from the perspective of understanding the impact of the transition on female participation in the labor force, because not enough is known about underlying economic structure to make such an assessment. The survey did not ask enterprise managers to distinguish between voluntary quits and involuntary layoffs, for example, in those cases in which enterprise workforces had declined. This is important in all the countries surveyed, because following the abolition of mandatory work requirements on all adult citizens, many women reportedly chose to leave the workforce voluntarily. Many surveys on the question have tended to conclude that workforce reductions, particularly in the former Soviet Union, have tended to be achieved through voluntary quits and attrition, rather than layoffs.

Neither is it possible, utilizing the current survey, to determine whether workers who left employment in the enterprises surveyed found jobs elsewhere, or whether they remained unemployed. There is evidence, however, that female participation in the workforce did not necessarily decline because of a decline in their representation in the workforces surveyed in the manufacturing and agribusiness sectors, because in the services sector there was a marked increase in female representation.

E. Summary Recommendations/"Best Practices"

The forgoing analysis and synthesis of results suggests a number of potential recommendations (or "best practices") which practitioners may consider when designing and implementing direct enterprise assistance activities in the ENI Region. Salient among these are the following:

Coping with the Macroeconomic Environment

- Much of post-privatization restructuring is blocked by the prevalence of insider-control and ineffective incentives to restructure. The best means to ensure restructuring of such enterprises is to insist on the imposition of a hard budget constraint while promoting an appropriate enabling environment and competition from new start-ups.
- Lack of effective stabilization policies and an exceedingly hostile enabling environment hurt agricultural producers disproportionately. Higher priority should be given to pushing for effective implementation of economic stabilization policies and reform of the enabling environment as it affects agriculture.

Targeting Direct Enterprise Assistance

- To ensure broad-based and sustainable impact, USAID should target intensive enterprise assistance toward those competitive sectors and enterprise profiles that have the best chance of succeeding, and rely on market forces to replicate the successes.

Nonetheless, the targeting guidelines should remain flexible, because they apply on average, and not in every case.

- Enterprises in less competitive sectors or profiles may be included in more broad-based training and information dissemination programs.
- Assessment of sectoral and subsectoral performance, confirmed by survey results, argues for concentrating direct assistance on light manufacturing, agribusiness services and other (nonfinancial) services, rather than heavy manufacturing or agricultural production.
- Small and medium-scale enterprises tend to perform better than large-scale ones, but the definition is so broad that, as with sectoral or subsectoral targeting, additional targeting criteria should be utilized.
- The strongest predictor of success relates to ownership form. This means targeting direct assistance toward new start-ups, despite the risk of small- enterprise failure. Direct assistance in the restructuring of privatized enterprises may be considered if they are not insider-controlled joint-stock companies.
- Enterprises are also likely to be more successful if they are closer to the consumer (agribusiness services rather than production, for example). Missions can rely on backward/forward linkages to extend the benefits of their success to suppliers and clients.
- Other targeting criteria, including product-line and employment policy flexibility, customer base and sources of financing, and adoption of Western business practices, should be factored into account.

Strategic Design of Direct Enterprise Assistance

- The "wholesale" approach, by which is meant channeling direct enterprise assistance through business associations or services providers, can be a particularly useful platform. But if self-sustaining local institutions do not exist to implement this approach, USAID activities should retain the flexibility to work directly with selected enterprises. The existence of at least some profitable "industry leaders" within a sector or region may need to precede efforts to develop successful enterprise associations or paying clientele for business services.
- In those countries and regions in which access to commercial bank financing is virtually a nonexistent option, direct technical assistance and training activities should only be implemented if the enterprises have access to private enterprise financing mechanisms sponsored by donor organizations.

- USAID implementors of direct enterprise assistance should be encouraged to work closely with enterprise financing mechanisms sponsored by USAID and other donors. USAID implementors' success rates in having their clients' financing projects approved by these sources, or by commercial banks, should be monitored as part of the intermediate results framework for enterprise development activities.

Monitoring the Impact of Direct Enterprise Assistance

- Enterprise surveys should be integrated into USAID's ongoing monitoring of the results of direct USAID enterprise assistance. They also should be utilized to develop feedback from USAID's clients and improve the strategic design of future activities.
- As part of USAID's ongoing results monitoring, the Agency's implementors should be routinely required, under the terms of their contracts and/or grant awards, to record on a periodic basis the number of enterprises assisted and the average amounts spent per enterprise, in broadly defined and common categories.

Afternote: Why Enterprise Surveys are Essential

Assessing the impact of foreign assistance programs is a difficult exercise, at best. Nonetheless, it is an essential check on the effectiveness of USAID activities and can be an effective management tool for programming future activities. In the area of direct assistance to improve the performance of private enterprises, surveys are an essential element of assessing program impact. All the more so because USAID in recent years has focused its strategy on management by results, and in the process has promulgated a detailed system of results indicators to monitor program implementation. The risk of this trend, in the absence of follow-up surveys to assess the actual impact of the enterprise assistance, is that attention will focus on quantity rather than quality.

The reason is that intermediate results indicators tend to focus on readily observable and quantifiable outcomes, like numbers of managers trained, or numbers of laws enacted. This is because they are intended to project the impact of the assistance *ex ante*, rather than assess its impact *ex post*. The difference has important implications for the design of future USAID programs. To follow through on the above example, although a large number of enterprise managers may have been trained, they may have been trained in the wrong thing, or their training may have been too brief to affect the way they made business decisions. Only follow-up enterprise surveys can determine whether the assistance was associated subsequently with successful enterprise performance.

Similarly, the number of laws enacted is only an intermediate proxy for how effective those laws will be in promulgating an enabling environment conducive to private enterprise development. Romania, for example, is reported to have passed more pieces of commercial legislation than any other central and eastern European country since the transition to market economies began seven or eight years ago; and the new government has put forward 4,000 more draft laws relating to the economy. By most accounts, however, the enabling environment for private enterprise in Romania is among the least conducive to private enterprise development in the region. Here again, if the purpose is to improve the business climate, only follow-up enterprise surveys can determine the effectiveness of legal and institutional reform from the enterprise manager's perspective.

VI. Linkages between USAID Assistance and U.S. Trade and Investment

The scope-of-work requires the contractor to examine implications of the findings of this evaluation for U.S. trade and investment strategies. As clarified in subsequent briefings with USAID staff, this assignment should be limited to the examination of two questions: (1) How can USAID help to facilitate U.S. trade and investment; and (2) How can U.S. trade and investment facilitate development objectives? These questions are addressed in the following manner. The first section provides an overview of USAID's activities relating to trade and investment promotion in each of the four countries surveyed, in the context of the findings about high- and low-performing sectors presented in section II, above. The second section briefly describes the patterns of U.S. trade and investment that are occurring in the four countries. The final section addresses the two questions that have been posed.

A. USAID Trade and Investment Promotion Activities

1. Kazakhstan

As with its overall strategy for Kazakhstan, USAID's strategy in the area of trade and investment has focused primarily on policy and institutional reform, and has been aimed at identifying and removing constraints to trade and development. The primary vehicle for dealing with trade and investment policy is a project which has as its principal goal helping Kazakhstan meet the requirements for membership in the World Trade Organization.

USAID has also directly facilitated the establishment of several joint ventures with the participation of U.S. companies in the food processing sector through its Food Systems Restructuring Program (FSRP). One of these joint ventures, the Koch-Tsesna meat processing plant, also received financing from CAAEF under the latter's direct investment program. In addition, IESC says that its volunteer executives have helped identify and establish contacts with potential U.S. trade and investment partners while serving in the capacity of U.S.-based "mentors" for enterprises they previously assisted as resident advisers.

Although U.S. trade and investment in the oil and gas and tobacco industries dwarfs the trade and investment flows resulting from the food processing joint ventures established with the assistance of the FSRP, nonetheless the assistance was provided in a subsector (agribusiness services) that was identified in this evaluation as high-performing.

2. Latvia

Since late 1991, USAID/Latvia has had approximately 61 activities plus 27 cross-linked activities. A number of these have had strong impact from a trade and investment perspective. IESC clients generated a 28 percent increase in exports post-assistance and recorded 29 contracts for procurement from U.S. firms within two years following receipt of the assistance. A number of these occurred in the pharmaceuticals industry, which is one among the light manufacturing industries identified as high-performing in this evaluation.

ACDI/VOCA programs were concerned largely with building industry associations, but a VOCA-assisted wood and forestry products company, and an ACDI-assisted food processing company stand out as particular successes. IESC, the Peace Corps, and the SUNY MBA program are credited with the success of the Latvian Tourist Board and subsequent linkage for international travel, a twinning connection in the U.S. for Baltic travel, and introduction of management systems capable of handling international business travelers. In the cases of food processing and tourism, the successes have been achieved in sectors identified as high-performing in this evaluation. The one exception is wood and forestry products, which may be one of those exceptions that prove you should consider targeting criteria as guidelines, not hard-and-fast rules.

The real payoff of USAID assistance, however, has probably been the pervasive assistance in all quarters that helped to establish a viable business environment.

3. Romania

As examined in more detail in earlier sections of this evaluation, Romanian trade and investment suffers from an extremely hostile enabling environment. This is confirmed by enterprise managers surveyed, who tended to cite inflation, interest rates, taxes and regulations as major impediments to their success than managers in any of the other three countries. U.S. assistance that is focused on developing a sound policy and institutional basis for the economy may, at the moment, offer more opportunities to enhance trade and foreign investment potential than any other form of assistance.

In such an environment, the opportunities for American companies to participate in the economy's development tend to be limited to trade, and USAID trade and investment activities have been limited accordingly. Four industry associations have been established by Land O' Lakes and ACDI/VOCA in the agribusiness sector, all with international trade linkages. Through these contractors' trade linkages, all four associations have been represented at regional and EU trade fairs during the past two years. ACDI/VOCA also has been involved in marketing research and trade information, including U.S.-hosted site tours by Romanian companies in search of new equipment and process techniques. In many instances, Romanian managers attribute their purchases of U.S. products to connections generated on these trips and through the contractor's network affiliations. CDC has also documented a minimum of \$10 million in purchased equipment and technology from U.S. companies by Romanian clients during the past two years, most generated through direct trade linkage by the contractor. In addition, the Romanian-American Enterprise Fund's activities include a program called *ACCES for Business*. It provides direct assistance, but also has developed 60 trade and marketing plans for client enterprises, and through IESC's ABLE network, has generated 27 validated links with U.S. firms that resulted in export agreements, and in five cases, direct investments in Romanian firms.

4. Russia

Because of Russia's vast size, this evaluation has been limited to consideration of USAID activities that have been carried out in Rostov-on-Don Oblast. This guideline is also followed in this section of the evaluation. The following activities fielded by USAID in Rostov under the

New Business Development Program (NBDP) included components that were related to promotion of U.S. trade and investment.

International Executive Service Corps/Rostov office (IESC/Rostov). The Rostov office, which serves businesses in Rostov-on-Don and the surrounding oblast, Stavropol and Krasnodar, has been working in the region since the end of 1994. It is estimated that about 22 different enterprises in the Rostov region received direct technical assistance from volunteer executives in 1997, and as of early June 1998, another 10 different enterprises had received direct technical assistance from volunteer executives in 1998. Following its pattern in other countries and regions, these assignments may lead to U.S. trade and investment through the IESC's network of retired American executives.

Center for Citizen Initiatives (CCI). CCI implemented the Economic Development Program (EDP) in Rostov-on-Don from September 1994 to March 1997. The EDP comprised 3 activities: (1) an information center; (2) free consulting services for companies; and (3) internships in the United States. The information center offered services such as a database, electronic mail and internet access for Russian companies seeking to establish contacts with potential U.S. suppliers, customers and investors. The internship program sent English-speaking managers of private firms on month-long internships with U.S. firms working in an analogous line of business to learn first-hand about American experience in conducting business.

Consultants from CCI worked with a large number (20 to 30) companies during the period of their visit, typically meeting with a new company every day. This is in contrast to IESC volunteers, who as a rule provide intensive on-site assistance to a single company for an extended period (6 weeks to 3 months). In addition, consulting services were provided free of charge to enterprises and entrepreneurs, whereas the living expenses of IESC volunteers are partially covered by recipient enterprises.

B. Patterns of U.S. Trade and Investment

1. Kazakhstan

As indicated below, official Kazakhstan trade statistics show a sharp increase in imports from the U.S. in 1997 over the previous 2 years:

	1995	1996	1997
Imports from U.S. (USD m)	72.5	66.3	201.7
Share of total imports (in percent)	1.9	1.6	4.7

According to the U.S. Commerce Department's National Trade Data Bank, U.S. exports to Kazakhstan rose from \$80.9 million in 1995 to \$137.9 million in 1996 and \$258.2 million in 1997. Thus, official U.S. trade statistics indicate much higher levels of U.S. exports to Kazakhstan (imports from the U.S.) than official Kazakhstan trade statistics, especially in 1996. While the reasons for the discrepancy between official Kazakhstan import statistics and official

U.S. export statistics are not clear, part of the explanation may have to do with the way official Kazakh trade statistics are compiled. According to *Kazakhstan Economic Trends* (October-December 1997, p. 139), official export and import data are based on customs statistics, and transactions that are reported too late are reflected in these statistics as transactions of the following year.

The following breakdown of U.S. exports to Kazakhstan in 1996 and 1997 is drawn from the National Trade Data Bank:

	1996		1997	
U.S. Exports to Kazakhstan	USD m	%	USD m	%
Total	137.9	100.0	258.2	100.0
Aircraft, spacecraft and parts	66.6	48.3	135.9	52.6
Reactors, machinery	18.7	13.6	73.3	28.4
Electrical equipment	6.3	4.6	18.2	7.0
Tobacco and tobacco products	8.7	6.3	5.6	2.7
Optical devices	3.6	2.6	5.3	2.1
Food and beverages	3.6	2.6	1.3	0.5

As indicated, products classified as "aircraft, spacecraft and parts thereof" were the leading U.S. exports in 1996 and 1997. Purchases of communications satellites accounted for most of U.S. exports in this category in both years (\$66.2 million in 1996 and \$130.5 million in 1997). In 1997, exports of "reactors and machinery" consisted largely of purchases of agricultural harvesting equipment and parts (about \$44 million) and equipment for the oil and gas sector (about \$16 million). Telecommunications equipment accounts for most exports of electrical equipment. The U.S. Commercial Service's Country Commercial Guide for Kazakhstan estimates that Kazakhstan imported \$71.1 million of telecommunications equipment, \$25.2 million of power industry equipment and \$2.3 million of equipment for the oil and gas sector in 1996.

Investment. During the period 1993 to 1996, the United States invested \$1.5 billion in Kazakhstan, accounting for 44 percent of total foreign direct investment. The United States was the largest foreign investor in Kazakhstan during this period, followed by South Korea (16 percent), the United Kingdom (15 percent), and Turkey (6 percent). In 1996, however, the United Kingdom and Korea were by far the largest investors, accounting for 35 percent and 31 percent of total disbursements, respectively, most of which went to the ferrous and nonferrous metals sector.

According to the U.S. Commercial Service's Country Commercial Guide for Kazakhstan, the largest investments by U.S. companies in Kazakhstan include:

-Tengizchevroil, a joint venture between Chevron and Kazakhstanmunaigaz, was formed as part of a \$20 billion agreement signed in 1993. More than \$800 million had been invested by January 1997.

- Philip Morris signed an agreement with Almaty Tobacco Company in 1993, under which it pledged to invest \$350 million through 1998.

- AES purchased the Ekibastuz-1 power plant for \$5 million in 1993, and committed to invest more than \$500 million over the next 6 years to renovate and upgrade the facility.

- Access Industries purchased the Bogatyr coal mine and 66 percent of the neighboring Steпноy coal mine for more than \$40 million and pledged to invest \$550 million in upgrading them.

In addition, the Caspian Sea Consortium, which in 1993 began work to explore oil and gas reserves in the northern section of the Caspian Sea, includes Mobil as a member along with five other international petroleum companies and the government of Kazakhstan.

Finally, the USAID-supported grant program, the Food Systems Restructuring Program, has facilitated investments by U.S. companies in dairy processing (Foodmaster) and meat processing (Koch-Tsesna).

2. Latvia

U.S. trade has increased by more than 30 percent with Latvia over the past two years, and foreign direct investment has increased by nearly 30 percent in 1997 alone. In its 1998 report on EU accession candidacy, the Ministry credited U.S. investment with 10 percent of all FDI, 28 percent of that in joint ventures, 52 percent in financial markets or share investments, and 21 percent in currency holdings (MOF 1998).

In 1997, the largest share of FDI came from Denmark (18.9 percent), largely as a result of several major alliances in Latvian transport and telecommunications. The Russian Federation accounted for 20 percent, but 9.5 percent is the result of energy transit credits. As a proportion, Russia's FDI has been trailing off and is expected to decline further. Meanwhile, as noted above, U.S. FDI has increased significantly, and now ranks either second or third, depending on the status afforded Russia's contribution. Singapore, Germany, and the UK round out the remaining top origins of investment (MOF 1998). These data may require caution in interpretation as insights from the American Chamber of Commerce suggest that several registered U.S. companies were actually Latvian-owned enterprises incorporated in the United States. In contrast, AmCham pointed out that official Latvian data does not account for as many as 50 U.S. investors who have privately placed money in Latvian enterprises.

FDI is expected to increase substantially in 1998 and 1999 with more aggressive privatization, removal of remaining restrictions against foreign investment, and enactment of property rights laws to secure land ownership (LDA, 1998). Foreign enterprises are now permitted to purchase privatization vouchers and to take title to land with government protections against future liability claims. New initiatives to involve the Latvian stock exchange in secondary markets may also encourage foreign investments.

3. Romania

Although there are disparities in reported data on all trade and FDI, the United States has been consistently among the top five sources for FDI and imports with slightly less favorable export performance. These results are not unexpected as Romania has close ties with Germany, Italy, and the Netherlands where trade is relatively strong and foreign investors are attracted to Romania to pursue factor cost advantages in wages and materials. U.S. trade is closely linked to foreign direct investment by more than 2,000 registered investors in Romania.

A majority of U.S. companies doing business in Romania are involved in financial activities or trade services. There are three U.S. registered bank branches with primarily foreign exchange operations and noncommercial services (i.e., not licensed for local deposits, lending, or clearing transactions). There also are slightly more than 1,200 trade enterprises (51% of all U.S. registered enterprises). These may be little more than proprietary agencies for import or export, or full-service international brokerage firms. There are 22 registered service firms in accounting, securities brokerage, and financing, but this also includes branch operations of several international public accounting firms that are (or have been) USAID contractors. Approximately 220 firms are registered as investors in alliances or joint ventures, such as Connecticut Manufacturing which is a major share holder in a Romanian machinery plant or McDonald's, which is a primary share holder in the country's umbrella franchisor that controls licensing over individual site facilities and partial joint ventures for restaurants. Most are minority shareholders, such as Ilieve Daniela Valeria, a firm with a small share in TEC Miaco for light industry fabricating. Nearly half of the remaining firms (estimated at 430 by AmCham) are representative offices, such as Digital Equipment's Bucharest office for computer sales and service, and Agrotech International that represents Massey Ferguson agricultural equipment.

Approximately 20 companies are defined specifically in the agribusiness area, but most are among the representative offices or agencies.

Trade has followed a similar pattern for U.S. companies in that a majority of trade is handled through the rather large number of agencies or company representative offices. U.S. imports of tobacco products, food and beverages, computers and information systems components, medical and dental supplies or equipment, and automotive products comprise nearly 65 percent of all imports from the United States. Agricultural and construction equipment represents 12 percent, chemicals and agricultural products 11 percent, and retail non-food items such as electronics about 6 percent. Industrial machinery, process technology, and materials represent a combined four percent, and two percent is miscellaneous (such as printed matter). These proportions have changed substantially since 1994 when tobacco and processed (or canned) foods represented more than half of all U.S. imports to Romania, and a third was concerned with agricultural products. Very little industry machinery or technology was imported during the early transition years with the exception of farm equipment.

Exports to the United States are not broken down into clear product lines, but they are defined by more aggregated categories. Textiles and clothing represent approximately 42 percent of export trade, and wood-related products including some furniture account for 23 percent of exports. Machine tools, small electrical equipment, and industrial components constitute 22

percent of exports, but this has been a rapid growth area of trade with new U.S. investments in bearings, machinery, and electrical component assembly plants. Glass and ceramic products represent seven percent of exports, mainly in handicrafts, tableware, and certain types of industrial insulators. The remaining six percent is scattered among miscellaneous products, such as paper products, software, cosmetics, home furnishings, and plastic components for appliances.

4. Russia

The following data on the level and distribution by sector of U.S. exports to Russia in 1996 and 1997 are drawn from the National Trade Data Bank:

U.S. Exports to Russia	1996		1997	
	USDm	% of total	USDm	% of total
Total	3340	100.0	3288	100.0
Meat	991.4	29.7	891.5	27.
Other food products	380.7	11.4	349.9	10.6
Tobacco and tobacco products	367.9	11.0	241.2	7.3
Reactors, machinery	454.9	13.6	684.7	20.8
Electrical equipment	206.8	6.2	261.0	7.9
Vehicles	158.9	4.8	160.2	4.9
Optical devices	147.0	4.4	164.2	5.0

As indicated, meat was the leading U.S. export to Russia in 1996 and 1997, and meat and other food products together accounted for close to 40 percent of U.S. exports to Russia in both years.

Investment. According to Goskomstat (1997, p.252), in 1996 U.S. investment in Russia amounted to \$1.695 billion, including direct investment, portfolio investment and other forms of foreign investment (for example, trade credits and other credits). The United States was the largest foreign investor in Russia in 1996, accounting for 26.1 percent of total foreign investment for that year.

Foreign direct investment in Russia has been concentrated in food production (27 percent of total FDI in 1996) and retail trade and catering (12 percent). Reflecting the composition of all FDI, U.S. companies have invested heavily in the tobacco, soft drink, confectionery and fast foods industries. Highlights of U.S. investment in these sectors include:

Mars built a chocolate and processing plant and a pet food plant in Stupino. To date, Mars has invested \$500 million in Russia.

RJR International acquired stakes in tobacco factories in the Krasnodar region, Lipetsk and St. Petersburg, and invested \$300 million in Russia through 1997.

Phillip Morris acquired stakes in 2 tobacco companies, one in Krasnodar and the other in St. Petersburg, invested \$110 million in Russia through 1997, and plans to invest an additional \$40 million in the Krasnodar Tobacco Factory in 1998.

Coca-Cola has opened bottling plants in several Russian regions, including St. Petersburg, Novgorod, Vladivostok and Krasnoyarsk, made investments in existing plants or with Russian partners in other regions (Krasnodar Krai, Rostov), established a wholly-owned subsidiary in Moscow, and is planning investments in other Russian regions (Samara, Orel). As of 1997, Coca-Cola had made investments in Russia totaling at least \$244 million.

Pepsi has built bottling plants or installed bottling lines in Samara, Moscow, and Vladivostok, and plans to build a \$56 million bottling plant in Nizhny Novgorod. Pepsi has also opened a chain of Pizza Hut restaurants in Russia.

McDonald's Canadian subsidiary has already established 24 restaurants and invested \$160 million in Russia since 1985, and is rapidly expanding in Moscow and other regions throughout Russia.

Baskin-Robbins built an ice cream plant in Moscow and a chain of retail outlets in major Russian cities. Investments for all of Russia amounted to \$35 million by the end of 1995.

Wrigley's is investing \$25 million to build a chewing gum plant in St. Petersburg.

Impediments to foreign investment in the Russian energy sector have limited commitments by U.S. oil companies to a fraction of their potential levels. The earliest investments by U.S. companies took the form of joint ventures with Russian partners. Existing joint ventures with U.S. participation include Conoco's Polar Lights venture (\$400 million invested by late 1997), and Phibro Energy's White Nights venture (\$120 million invested by late 1997).

In 1995, Atlantic Richfield, or ARCO, purchased a stake in Lukoil, Russia's largest private oil company, for \$250 million by participating in an issue of convertible bonds.

Most recent investments by U.S. companies in the Russian oil and gas sector have taken the form of participation in major oil projects. These projects fall into two basic categories: those that are moving forward, and those that have been stalled or sidetracked (Gordon, NYT, Sept. 5, 1997).

Two major projects with the participation of U.S. companies, Sakhalin-1 and Sakhalin-2 (Sakhalin Energy Investment), are moving forward because they are "grand-fathered." In other words, they covered by production-sharing agreements negotiated separately with the Russian government before the issue of legislation on production-sharing agreements became entangled in the Russian parliament (The Economist, Nov. 15, 1997). The U.S. companies involved are:

Exxon, which is part of the consortium Sakhalin-1. Other partners in the consortium are Sodeco (Sakhalin Oil and Development Company, a group of Japanese companies with the

Japanese National Oil Company as a major shareholder), and Rosneft. The project was still in the exploration stage at the end of 1997, with estimated investment of \$200-300 million.

Marathon, which is a partner in Sakhalin Energy Investment (Sakhalin-2), together with Mitsui and Mitsubishi of Japan and Anglo-Dutch Shell. Sakhalin-2 is up and running, with projected investment of \$10 billion.

Retail trade and production of food and other consumer goods were among the sectors leading the recovery of the Russian economy in 1997. Since U.S. companies have invested heavily in food processing and catering, and since a large share of U.S. exports consists of food products to be distributed through the retail trade network, it is reasonable to conclude that U.S. trade and investment are correlated with high-performing sectors, and indeed that U.S. trade and investment are contributing to the recovery of these sectors.

C. Findings and Implications

1. How Can USAID Help to Facilitate U.S. Trade and Investment?

There are at least four distinct ways in which USAID activities can help to facilitate U.S. trade and investment. These are (1) assistance in supplying market information and logistical support; (2) help in understanding and negotiating the often difficult terrain of national and local officialdom; (3) promoting economic policy and institutional reform; and (4) initiating contacts between American companies and local counterparts. This section reviews how USAID has approached this role in the four countries surveyed in this study.

Market information and logistical support. Almost anyone who has had experience in the ENI region recognizes the fact that foreign companies face enormous hurdles when trying to do business there. These are compounded when one gets out of the countries on track for NATO or EU membership and into the vast remainder, out of the capital cities and into the regions, out of the Marriott and into the Intourist. Acquiring any sort of useful market information requires trustworthy local logistical and technical support, plus a lot of time, diligence and expenditure of resources. Many U.S. companies have found that without some form of continuous on-the-ground presence, doing business is not feasible; and that operations may require sustaining years of losses before getting out of the red. In short, without being able to rely on the networks that USAID helps to establish, transactions costs are extremely high, representing very real barriers to entry.

Intermediation. Another potential area of assistance, and one related to providing logistical support, is in organizing site visits and meetings with the necessary officials at both the national and local level. The establishment of a joint-venture in transitional economies can test the patience of any business person due to the number of approvals, applications and meetings required from different agencies (e.g. Department of Economy, Department of Foreign Investment, Department of Finance, etc.). Everything from receiving an approval to invest in a region, to setting up a bank account can be a time-consuming arduous task. Previous surveys on investment promotion services (e.g. USAID Survey on Investment Promotion in Latin America

and Asia) demonstrate that effective site visit facilitation and the provision of an intermediary role between government officials and the foreign investor/business person can be highly effective and valued.

It is frequently the case, particularly when the activity is located in a region far from the capital city and the U.S. company cannot afford to maintain local on-the-ground presence, when intermediation by local technical experts trained by USAID can facilitate negotiation of local and national officialdom in the ENI region. This is one means by which the impacts of more broad-based USAID training activities may come into play.

Policy and institutional reform. The overwhelming economic lesson of the modern era is that trade and investment cause increased growth, income and employment. Thus, increased trade and investment is an end in itself. Accordingly, much USAID assistance to developing countries and economies in transition is designed specifically to relieve various forms of constraints and impediments to increased trade and investment. The best run investment promotion program (e.g. investor facilitation) will not produce results if the policy and institutional environment within which it operates is not conducive to foreign investment.

There are a number of areas that are of critical importance to investors and in which USAID and other donors could work with governments -- at either the national or local level: 1) establishing a stable monetary and fiscal policy; 2) promoting adequate, readily available and competitively priced infrastructure (e.g. water, electricity, transportation, fuels, building and communications); and 3) organizing stable, transparent and supportive government structures (e.g. one-stop investor facilitation/approval center).

Contacts between American companies and local companies. There are a number of different ways to promote business linkages between U.S. and local companies. One approach is through the distribution of targeted information on: attractive sectors, company profiles, and local financial partners. This activity typically requires a minimum amount of resources and can be effective in generating an awareness about specific opportunities. It can be done by disseminating information through the internet, direct mailings, associations and other business organizations (e.g. Chamber of Commerce). This evaluation's survey results tend to confirm that information dissemination is a highly effective means of promoting successful private enterprise performance.

Another approach requires more resources and involves having technical experts work directly with foreign and local companies via a technical assistance and/or training program. For example, "dealmaking" and "buyer contacts" typically involves someone researching and identifying potential partnerships. That person then works directly with the potential partners and makes sure that they each have enough information to initiate a dialogue and future working relationship. This matchmaking role essentially focuses on doing whatever is necessary to develop a sufficient level of trust so that a business partnership can take root. Here again, the survey results tend to confirm the value of this type of assistance in terms of the enterprise's subsequent performance.

A final approach, and one that typically falls in between the least expensive information outreach and the more expensive matchmaking is providing support for companies to attend trade shows and trade missions. This approach supports the premise that investment can follow trade;

therefore the first step is to initiate some contacts between buyers and sellers of specific equipment and services.

2. How Does U.S. Trade and Investment Facilitate Development Objectives?

The overwhelming economic lesson of the modern era is that trade and investment cause increased growth, income and employment, which by any definition is economic development. Thus, increased trade and investment is an end in itself, one which many USAID activities try to promote. With that said, there are several distinct ways in which U.S. companies can facilitate the achievement of development objectives supported by USAID in the ENI region, and in so doing contribute to improving the local business climate.

Policy dialogue. As confirmed by every Mission interviewed for this evaluation, U.S. companies can represent a decisive force for positive change in the policy and institutional environment governing economic activity. There is rarely a better advocate for reform of the enabling environment than foreign companies that are either investors or potential investors.

Increasing competition. American companies can play a decisive role in increasing competition, and thereby promoting improved quality and performance of local enterprises. By wide margins, the survey results tended to show that the enterprises in the ENI region tended to increase the quality of their production in response to increased domestic and foreign competition.

"Market test" of USAID assistance. Many USAID implementors of direct enterprise assistance work actively to promote linkages with U.S. companies that will be followed by trade and investment. Although the gestation period necessary for this to occur may be extensive, there may be no better "market test" of the effectiveness of USAID assistance than the degree to which it subsequently brings in private U.S. trade and investment.